CONTRACT WITH AMERICA—OVERVIEW

HEARINGS

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JANUARY 5, 10, 11, AND 12, 1995

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SUBMISSIONS FOR THE RECORD

CONTRACT WITH AMERICA—OVERVIEW

THURSDAY, JANUARY 5, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 1:15 p.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

[The press releases announcing the hearings follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE PRESS CONTACT: Ari Fleischer
December 30, 1994 (202) 225-8933
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ARCHER ANNOUNCES *CONTRACT WITH AMERICA* OVERVIEW HEARINGS

Congressman Bill Archer (R-TX), Chairman Designate of the Committee on Ways and Means, today announced a series of overview hearings on the *Contract with America*, the series of 10 bills offered by the Republicans as a national legislative agenda. The first hearing will take place on Thursday, January 5, 1995, beginning at 1:00 p.m. in the main Committee hearing room, 1100 Longworth House Office Building. On that day, the Committee will hear testimony from House Speaker-Designate Newt Gingrich (R-GA). **Three additional overview hearings will be held on Tuesday, January 10, Wednesday, January 11, and Thursday, January 12, 1995, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m. each day.**

Oral testimony at these initial hearings will be heard from invited witnesses only. Witnesses will include individuals from the general public, governors, economists, scholars and other interested organizations. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing. Additional hearings on specific elements of the *Contract with America* will be announced for additional days in January at which time the interested public may testify.

BACKGROUND:

Five of the 10 bills contained in the *Contract with America* are under the jurisdiction of the Committee on Ways and Means. They include:

The American Dream Restoration Act: Families today often spend more money on taxes than they do on food, clothing and shelter combined. Just the act of becoming a family - marriage - is penalized by a tax code that makes a couple pay more in taxes than they paid as single people dating each other. To allow families to keep more of what they make, the *Contract* provides for a $500 tax credit for each child under the age of 18 for families with adjusted gross incomes under $200,000; provides relief from the marriage tax penalty, and provides new opportunities for families through a new Individual Retirement Account, called the American Dream Savings Account.

The Job Creation and Wage Enhancement Act: To create more high-paying, upward moving jobs for Americans, this bill includes capital gains relief to stimulate savings and investment; neutral cost recovery; expensing for small business; an increase in the estate tax unified credit; and restoration of the home office deduction.

The Family Reinforcement Act: To help families come together and stay together, this bill includes a maximum $5000 refundable tax credit for adoption expenses and a credit of $500 per parent or grandparent who lives at home and is unable to perform daily living activities.

The Senior Citizens Equity Act: This bill would repeal the Clinton Administration tax increase on Social Security; increase the Social Security earnings limit; provide tax incentives for private long-term care insurance; and allow accelerated benefits under life insurance policies to aid those with terminal illness.

(MORE)

The Personal Responsibility Act: Ending the cycle of welfare dependency in the next century by revolutionizing the welfare system is essential to our growth as a nation. This bill requires welfare recipients to work; forces fathers to participate in work programs if they fail to pay child support; eliminates most welfare payments to most people who are not American citizens; limits the time people can spend on the welfare rolls; and creates a powerful disincentive so children on welfare don't have children they can't afford to raise.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Persons submitting written statements for the printed record of the hearing should submit at least six (6) copies of their statements by the close of business, Thursday, January 26, 1995, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. An additional supply of statements may be furnished for distribution to the press and public if supplied to the Committee Office, 1102 Longworth House Office Building, before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. Statements must contain the name and capacity in which the witness will appear or, for written comments, the name and capacity of the person submitting the statement, as well as any clients or persons, or any organization for whom the witness appears or for whom the statement is submitted.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

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ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

CONGRESSMAN BILL ARCHER - CHAIRMAN

FOR IMMEDIATE RELEASE
January 4, 1995

CONTACT: Ari Fleischer
(202) 225-8933

GINGRICH TO TESTIFY TOMORROW

-OVERVIEW OF CONTRACT WITH AMERICA-

WASHINGTON - Speaker of the House Newt Gingrich (R-GA) will testify on the *Contract with America* at an overview hearing of the Committee on Ways and Means tomorrow, Thursday, January 5, 1995, at 1:00PM. The hearing will be held in room 1100 of the Longworth House Office Building.

Gingrich's testimony will follow the Committee's official organizational meeting at 11:00AM, which is open to the public. The Committee will reconvene at 1:00PM to hear the testimony of the Speaker.

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Chairman ARCHER. This being the first official hearing of the Ways and Means Committee, I have a couple of housekeeping comments to make before we proceed. First, I would like to welcome and introduce all of the new members of the committee participating in their first hearing in order of their seniority on the committee, Jim Ramstad of Minnesota; Dick Zimmer of New Jersey; Jim Nussle of Iowa; Sam Johnson, Texas; Jennifer Dunn, Washington; Mac Collins of Georgia; Rob Portman of Ohio; Phil English, Pennsylvania; John Ensign of Nevada; and Jon Christensen of Nebraska.

The members of the committee should also be aware that the Speaker originally committed to be with us for 1½ hours, but we now have about 1 hour and 10 or 12 minutes left. He does have other engagements. I have one last housekeeping announcement, instead of 10 a.m. next Tuesday, the full committee will commence its hearings at 9 a.m.

This meeting today is truly historic. It is profound, and I, for one, am emotionally touched by it. It is the opportunity that I have waited and prepared for for a very long time, and it is a responsibility that I will carry out with the interest of the American worker and taxpayer as my first priority.

It is also historic to commence a hearing with the leadoff witness being the Speaker of the House of Representatives. I intend to chair this committee in as bipartisan a manner as possible. I remember very fondly my days when the committee was chaired by one of the greatest legislative craftsmen in the history of the Congress, Wilbur Mills. Much has changed since then, but collegiality, respect, and simple fairness should not change.

I hope we can again make those virtues our way of doing the people's business for it is the people, working Americans, taxpayers, to whom we all, Democrats and Republicans alike, owe our allegiance. As this committee moves forward with its agenda, an agenda for the next century, we must remember that the American people are watching. They are watching this great and historic committee with very short patience.

The people have often heard promises made from Washington that were abandoned once the elections were won. Voters were promised a smaller government that spends less, but it did not happen, and voters before were promised tax cuts for which they are still waiting.

No one knows better than you, Mr. Speaker, that this year is different. Congress is different. We are different, and because of that, America will be different. Beginning today we will take action to implement the promise, no, the Contract that we made with the American people last fall, and in the next 100 days we will cut spending and we will cut taxes, and we will revolutionize welfare to put America on a better track.

Our agenda for the next century will renew the American people's faith in Congress, their government, and most importantly in the direction of our country, and we are going to do this in a new manner. We will carry out these changes with fewer staff and less money. We have already cut this committee's staff dramatically and the spending dramatically to maintain that staff. We have cut the staff by more than one-third, and we will do more with less.

As I have always done, I will continue to fill out my own tax returns. We passed as our last act last night the placing of Congress under all of the laws that we put on other people. I personally believe it would be wise if every member of this committee prepared his or her own tax return so that we will either fix it or we will suffer with it.

I will also continue my longstanding policy of not accepting PAC money. America is a very different place today than it was when the last Republican majority controlled the House of Representatives in 1954. In 1954 the Federal Government spent $71 billion. Last year the Federal Government spent $1.5 trillion.

In 1950 the Federal Government spent $282 for each American citizen. In 1990, the Federal Government spent $5,032 per capita, and it has increased since then. In 1954 the Federal Government took $30 billion from the taxpayers through the income tax. Last year we took more than $510 billion in income taxes. In 1955 there were 409,000 words in the Internal Revenue Code. Today there are over 110,000 people working for the IRS and 1.3 million words in the Tax Code.

Those 110,000 people working for the IRS compares to only 51,000 in 1955, and in 1954 the Federal deficit was $1 billion. Last year it was $203 billion. In 1954, 5 percent of American children were born out of wedlock. In 1991, the last year on which we have any statistics, that number of all children born out of wedlock was 30 percent. In 1954 the average American city of 100,000 suffered with 175 people per year victimized by violent crime. In 1991, a city of that same size had 758 people fall victim to violent crime.

Those facts are why the Republicans made our Contract With America. The Government is too big, and it spends too much. The American people question whether the high taxes that they pay for countless social programs are doing any good. We believe our Contract With America will begin to fix those problems.

Mr. Speaker and fellow members, the next century is almost upon us. These numbers and the human lives whose sufferings and joys they chronicle remind us that a big government who taxes more and spends more does not necessarily accomplish more. Over the last 30 years government in this country has spent over $5 trillion on welfare programs, and yet the Census Bureau tells us that there are more people in poverty today after all of that money than there were when it began 30 years ago.

I believe we must stop measuring compassion by the amount of money the Government spends. We must measure compassion on how much better life becomes. Our committee, the oldest in the Congress, had its first meeting in 1789, and it has a tremendous obligation to wisely rewrite the tax laws so that we may make life better for American people.

Our obligation to the people today remains the same as it was when it began. We must ask working Americans for the least possible amount of taxes so that Government will do only those things that they cannot do for themselves. The five bills in the Contract With America that are within the jurisdiction of this committee kick off our agenda for the next century, and they will do just that.

Before hearing from our witness, I would like to recognize the ranking minority member of the committee, Mr. Gibbons.

Mr. GIBBONS. Thank you, Mr. Archer, and I shall be brief, because I want to hear the witness and I want members to have an opportunity to examine the witness.

First, Mr. Gingrich, we welcome you here. We remember your appearance here and work with us on the trade legislation last year, and your constructive input.

Second, we recognize that the voters have spoken. I want to commend Mr. Archer and Mr. Moseley of the staff for their orderly transition. We worked together and worked out our differences, and we were treated fairly under the ground rules that were established. We are ready to go to work.

Mr. Chairman, your Democratic members are organized and prepared to shoulder their part of the responsibility. We deem it to be primarily our responsibility to make sure that mistakes of the past are not repeated and that we look forward to the future with as clear a vision as we can command.

One of the mistakes of the past is that in 1981, in this committee, we entered into a rather massive tax cut but found that there was no followthrough on the spending cuts. As a result, the national debt of this country ballooned from about $1 trillion to about $4 trillion. That has become the heaviest burden upon middle-class America. I think the continued reduction of this indirect tax burden, or debt burden, is the most important thing that we can do for middle-class Americans.

Our middle-class Americans live largely on borrowed money; they are not lenders. Some save and more should, but the burden that has been cast upon them by failure to follow through with the so-called revolution that began in 1981 has been the cruelest hoax to those people and we need to correct that.

Certainly in this time of relative prosperity, we should continue very vigorously to reduce the Federal budget deficit. I don't want to be partisan and I don't want to be critical, but I noticed the very first pamphlet that has been prepared for us today has all the nice beautiful pictures in it, but has nothing in it as far as cost is concerned.

We Democrats will be asking a lot of penetrating questions about the cost of all of this. We have learned our lesson on that, and we do not intend to repeat it. Finally, let me say that I realize that the rules have changed, that there will be only one opening statement from each side before we begin these committee hearings. I do not intend to monopolize my ranking position here so I will share it amongst our Democrats in a democratic manner.

Thank you, Mr. Chairman. We are ready to work.

Chairman ARCHER. I thank the gentleman from Florida. Without any objection, any opening statements that might be desired by any other single member of the committee can be submitted and put in the record.

[The opening statements follow:]

BARBARA B. KENNELLY
STATEMENT ON THE "CONTRACT WITH AMERICA"
THE WAYS AND MEANS COMMITTEE

JANUARY 5, 1994

Thank you Mr. Speaker for coming before our committee today.

I know that both Democrats and Republicans are looking forward to your explanation of the legislative provisions in the Contract with America. My first concern when I look at the Contract is - what impact will this have on the budget deficit. We have finally begun to make some progress on reducing the deficit and I would hate to see that improvement undone.

I hope you agree that the deficit is one of the most serious long-term problems facing our great nation. Every dollar of debt represents more than a dollar in future taxes and high deficits tend to drive interest rates and therefore monthly mortgage payments up. This is a double dose of bad news for the middle class.

Some have said that certain tax cuts may pay for themselves and that perhaps we should adopt a "dynamic" method of budget scoring to reflect that philosophy. With all due respect, that kind of thinking helped create the deficit we are now attempting to shrink. Advocates of the tax breaks of 1981 made the same arguments. It is no accident that our deficit began to soar shortly after those tax changes, as well as increases in defense spending, were enacted. Now it seems it's deja voodoo all over again.

I am also concerned that some of the Contract's welfare provisions seek to punish the poor, more than move welfare recipients into work. Let me first say that I support strong welfare reform legislation, including mandatory and strict time limits on benefits. However, some of the Contract's provisions seem aimed more at punishing children than demanding personal responsibility.

For example, the legislation prevents children in poverty from receiving AFDC if paternity is not established, regardless of whether the mother does <u>everything</u> possible to cooperate in identifying the child's father. This means a mother could give the exact name and address of the presumptive father but still not receive AFDC benefits for her child because the state has a large backlog of paternity establishment cases. In fact, states now take an average of six months to a year and half to establish paternity, largely because of staff shortages. For this reason, it is has been estimated that this provision alone might deny AFDC assistance to 2.8 million children. Rather than "empowering" poor families, this requirement appears as though it will hold mothers and their children hostage to government bureaucracies.

While it is not it in our committee's jurisdiction, I must also voice my strong reservations regarding the Contract's proposal to repeal funding for community policing and crime prevention. Are the authors of the contract content to merely see these crimes committed and then to punish them?

Mr Speaker, I look forward to your discussion of these and other important issues in the Contract with America.

STATEMENT OF REPRESENTATIVE JIM RAMSTAD
WAYS AND MEANS COMMITTEE
HEARING ON THE CONTRACT WITH AMERICA
January 5, 1994

Mr. Chairman, it is a pleasure to be here this afternoon to begin consideration of the most proactive, innovative and positive legislative agenda Congress has considered in decades.

When Americans elected a Republican majority last November, they signaled their support for changing the way business is conducted in the nation's capital.

They told us they wanted Congress to comply with the laws it imposes on the rest of the nation, cut committee staff, employ intellectual honesty in the federal budget process and raise the threshold for increasing income tax rates.

Yesterday, we proved to the American people that we are committed to these procedural reforms.

Today we begin consideration of legislation that will prove to voters that we are sincere about balancing the federal budget, promoting economic growth, easing the tax burden on American families, reforming the dependency-breeding welfare system, strengthening our national defense, reducing burdensome federal regulations and implementing substantive legal reforms.

This committee alone will have the awesome responsibility of considering five of the ten bills included in the Contract.

I look forward to working with the other members of the committee on these critical legislative initiatives, and I look forward to working with the architect of our revolution -- today's witness, Speaker Newt Gingrich.

WAYS AND MEANS COMMITTEE HEARING
REP. MAC COLLINS (GA-3)
JANUARY 5, 1995

As Chairman Archer has indicated, today does mark an historic meeting of the Ways and Means Committee under a new majority and a new leadership.
The Contract with America means a new agenda for Congress, as well as for the entire nation. But more than symbolic, this combination of legislative reforms means substantive change. It is an aggressive agenda that has, at its foundation, the intent to reduce the oppressive power the federal government has accumulated in the last several years. The components of this reform package return the power to govern one's affairs to where it should be: on a local level, in the hands of American citizens.

Opponents of the Contract with America argue that the costs of the reforms outweigh the benefits provided to the American public. Detractors blindly argue that the budget deficit; the requirements of the Balanced Budget Amendment; and budgetary restrictions mandated by Congressional "pay-as-you-go" rules, will prohibit the ability of Congress to "pay" for these reforms. But a realistic look at these reform measures, and the process necessary for passage, indicate these measures will be self-financing as they are implemented in "real world" market place settings.

The annual budget process will provide the major vehicle for the passage of these reforms. Each year, the Budget Committee reports a resolution to the House that provides the necessary blueprint for all federal spending. This budget blueprint is then sent to the Appropriations Committee that divides these spending "directives" into 13 different spending, or "appropriations" bills. The Appropriations Committee and Subcommittees must spell out the details of all federal spending according to the direction given in the Budget Resolution.

By reducing spending levels set by the Budget Resolution and the appropriations process, we will offset the costs associated with tax-related reforms in the Contract with America. These savings will provide the necessary offsets needed for the aggressive tax reform measures currently before the Ways and Means Committee.

Additionally, many of the reform measures will prove to be self-financing in the "real" world of economic behavior and growth. A tax credit for children will enhance family income, savings and buying power. Correcting the marriage penalty will provide the same savings and investment power for families. Provisions to reform welfare and restore self-dependency mean fewer people will be receiving government checks; and more will be wage earners, paying taxes. Eliminating the unfair tax penalties placed on able-bodied senior citizens who choose to work, means that more seniors can return to the work force, earn wages and pay taxes on their earnings.

Tax reform affecting the private business sector means increased investment and a higher turnover of money. More ivestment means more economic growth and more job creation. Creating new jobs means a stronger workforce and a larger pool of citizens saving, investing and paying taxes.

The Contract with America offers a series of reforms encouraging economic growth through savings, investment and increased job opportunities. Through the budget and appropriations process, the new Republican leadership of Congress, will provide the financing framework for these necessary reform measures.

Chairman ARCHER. Now it is my great privilege to welcome the gentleman who has had a bigger role in inspiring and crafting the Contract With America than any other single person in this country, the new Speaker of the House, Newt Gingrich. We will be pleased to receive your comments.

STATEMENT OF HON. NEWT GINGRICH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA, AND SPEAKER OF THE HOUSE OF REPRESENTATIVES

The SPEAKER. Well, let me begin by thanking you, Chairman Archer, and I want to thank the Ways and Means Committee for the way in which it has prepared for this historic day. I am not sure we have ever had a committee hearing of a committee of this importance that began on the second day of a Congress. And, I have to say, I don't know about the rest of you, I am a little bit tired.

I closed the House last night at about 2:25 a.m., and I just really appreciate the workmanlike attitude of the committee. I also want to thank Mr. Gibbons again for the courtesies you showed me last year and the great honor you showed me in allowing me to sit as sort of, I guess, an honorary member of the committee during a hearing on the GATT agreement. I think our bipartisan work on NAFTA and on GATT were good for America. They are good for job creation, and I feel in that sense that with this committee I have always had a long relationship of being able to try to find some bipartisan agreements. In 1986, for example, this committee was very bipartisan in a very difficult process. I look forward to working with you now.

It is also, as you immodestly point out, an extraordinarily important committee, both in its historic background and in its obligations to the Contract. This is a committee which, in the tradition of governments, had to be created immediately because without this committee there was no resources for the government at all, so you have a very distinguished, but also a tremendously responsible job.

I want to say that I think that we are at the edge of a potential opportunity of historic proportions. We met with the President this morning. Bipartisan leadership meeting, Congressman Gephardt and Congressman Bonior and Congressman Fazio were down there. All three of them were down along with Congressman Armey, DeLay and myself and Senator Dole and Senator Lott and Senator Ford and Senator Daschle with the President and Leon Panetta. I want to report to you that I thought it was an extraordinarily positive meeting, that there was a spirit in that room—to use the term I had picked up from Congressman Wolf yesterday in the prayer service—there was a spirit of reconciliation, of trying to work together openly, of trying to solve problems and of trying on a bipartisan or nonpartisan basis to listen to the American people. And I left that meeting feeling that we had just a remarkable opportunity to work together, to maybe put off the rhetoric of the 1996 Presidential campaign for at least 9 or 10 months and to genuinely focus on getting some things done.

So in that spirit, I would like to outline sort of my thoughts as the newly elected Speaker and give you a framework in which, from my limited perspective, I would hope you would engage over the next 10 or 12 months.

Let me start at the larger level for a second, and then come down to the specifics of the Contract. I believe that we have reached a turning point in American history. I believe there are four primary goals that are at the heart of where we have to go, and they are fairly precisely definable, and they should shape every committee in the House, and they should shape the way in which we work with the administration, and by the way, this morning we had a very good talk with the President about the possibility of Vice President Gore coming in January to the Republican Conference and having a discussion of Reinventing Government—again, to establish this notion that a bipartisan team is going to do everything it can to reach out and work together.

The first goal, I think, has to be to take seriously the Alvin and Heidi Toffler concept of the third wave information age that follows on a first wave agricultural society and a second wave industrial society. I mention this because if it is true, and I believe it is, I think this concept then makes us rethink a lot of the Tax Code, and it makes us ask questions.

For example, why are we discouraging home offices when maybe in the information age we should be encouraging them? Why do we make it harder to be a small entrepreneur when maybe we should be making it easier to start your own business? If you look at California, which is in many ways the forerunner State of this economy, and I know that Congressmen Thomas and Matsui and Stark and Herger can cite their own experiences back home, the fact is we are entering a period of enormous change. And maybe just as there was an agricultural era economy and then Adam Smith wrote the "Wealth of Nations" to design the transition, and then there was an industrial era economy, we literally need to be thinking about the totality of change.

We are being listened to and interestingly I just came from the Library of Congress where we put the Thomas system—named for Thomas Jefferson, not Bill Thomas—online through the internet so that the U.S. House will now be accessible worldwide in 84 countries in real time by anyone who wants to access it. Now, that is an example of the direction we are going; I would suggest to you and to your staff and to the witnesses you bring in that on about every policy we should ask the question: Does it accelerate our transition into a third wave information age or does it slow it down?

Does it increase the freedom of entrepreneurs and individuals to have the resources to get there or does it weaken them? I believe you will find that you are shaped by different considerations than you might have expected.

Second, we are in the world economy. A bipartisan majority argued aggressively for being in the world economy, but I believe that means we should ask of every corporate witness the following question: Under what circumstances would you create the next thousand high-value-added jobs in the United States? If you are—rather than gripe and complain and whine and browbeat, if you are a multinational corporation, how do we have to change the American government, the American litigation system, the American regulation system, and the American taxation system so that the best rational investment to create jobs in the planet is the United States of America? We need to be advised by those who are making the decisions.

I want every community in America to be the first stop for the next good job, and that is a totally different agenda than, first of all, punishing businesses until they get ready to leave and then complaining because they are not patriotic after we drive them offshore. So we need to really think about it if we are going to be in the world market; I worked with this committee to maximize that process. And I hope when Chile and Venezuela and Colombia and others are back this year, we had better make sure that while we are in this giant world market the best place to create a job is the United States.

Third, as I said yesterday, the welfare state has failed and in failing has had an extraordinarily destructive impact, but I was told and I still find this so hard to believe that maybe one of you can correct me if I am wrong, I was told that the act of marriage—under the earned income tax credit at $11,000 a year for one person and $11,000 a year for another person—the act of marriage costs you, on a $22,000 income, $4,600 in earned income tax credit.

I have had my staff check that three times with the Ways and Means staff, so it is probably the right number, but I can't believe it. I mean, how can we have a Tax Code—my younger daughter, who is fairly well off, has an MBA and is married to a CPA, called me 1 day and first got me really going on this. This goes back to Millicent Fenwick when Bill Thomas and I were freshmen working on this issue; the Tax Code punishes you if you get married. It punishes us if you stay married and in Social Security it punishes you if you decide not to get divorced.

The signal we send economically in this country is destructive. Then we designed a pattern of rising so that we punish you if you start to be successful. We punish you if you try to get off welfare. A member of Jimmy Carter's Atlanta project, a woman whose credentials are impeccable—she is African-American, she is a cultural anthropologist, she is a Ph.D. from Berkeley, she is working in Atlanta with the poor—tells me, you know, in every public housing project, there is a candy woman. A "candy lady" was the term she used. She goes down and she buys candy wholesale and she illegally sells it to the children for a markup, not having a business license, but providing a service, and we have made it legally impossible for her to take the risk of opening a candy store.

We have raised the first step to dignity and capital accumulation and profitability so high that she can't take it. Now, this is not Gingrich the suburban Republican, this is a very leftwing intellectual working in Atlanta, telling about the reality of what she encounters when she sees people. And, by the way, the most powerful statement of that is Mario Vargas Llosas' introduction to Hernando DeSoto's "The Other Path," which is a study of the poor in Lima, Peru. It shows how the Government punishes the poor and prevents them from going into business, and how in Peru they simply created an entire economy which is not legal, but it is not criminal, it is just out there.

Well, guess what, in every major city in America, you will find an economy which isn't criminal, but it is not legal, and so I would hope we would look at these, notice how these three fit together. If we are moving into an information age, don't we have to figure out how we carry the poor with us? Don't they have to have every right to have as much access as anybody else? Shouldn't the Tax Code favor them in having a chance?

I will give you a nutty idea. I am just tossing it out because I want to start by getting you to think beyond the norm. Maybe we need a tax credit for the poorest Americans to buy a laptop. Now, maybe that is wrong. Maybe that is expensive. Maybe we can't do it, but I will tell you, any signal we can send to the poorest Americans that says we are going into a 21st century third wave information age and so are you, and we want to carry you with us, begins to change the game.

Second, we want to say to every American, the world market is going to be tough, but we are at least not going to have our government punish us while we compete, and so we have got to find a way to be honest about it, and I believe it is going to be very tough to compete with China, Germany and Japan. I think anybody who thinks we are going to take on the Asian tigers, and that it is going to be a lark totally misunderstands the intensity, the competition and the aggressiveness of our competitors, so I think we better rethink that.

Third, if we do it right, we actually liberate the poor to seek prosperity while making those transitions, but that requires changing our core laws.

Last, I want to pick up on what Congressman Gibbons said, because I agree with him, and this is going to make it much harder, and I know that my dear friend, Mr. Archer, one of the most fiscally conservative Members of this Congress, agrees entirely with this. We have to make these three transitions while moving to a balanced budget by 2002.

Now, I don't believe you can honestly get there faster, at least not without a crisis mentality, but I don't see any reason why as mature adults we can't establish a glidepath this year that is honest and serious and has integrity, that gets us to a balanced budget by 2002, and that means doing things differently. I would recommend you look at the major folks who have been successful in transforming companies, starting with Peterson at Ford Motor Co., and listen to them and say, all right, what do we have to do? We are going to come right back to this again and again.

Now, let me give you one example of breaking out. Many of you know about the old consult answer gimmick of what they call the nine dot problem where you ended up trying to cover the nine dots with four lines, and you finally had to go outside the dots to do it. I am not going to spend your time as a witness trying to show you, but conceptually what the consultants were getting at is that we artificially create frameworks that stop us from thinking cleverly.

I want to talk about Medicare for 1 second, then I will talk about the Contract. What this city wants us to do is to be so stupid that we are guaranteed to fail. We just went out—Dick Armey and Tom DeLay and I went out and did a totally positive press conference about our meeting with the President, and we stood at the White

House, you will see this later on today on C–SPAN; you can watch it on videotape and measure it for yourself.

We said it was a great meeting, a terrific dialog, a positive start. We are going to cooperate on every front. We are going to set up staff task forces. We are going to try to find ways to work together.

The second question we got from a reporter was "How do you think it will break down"? Let me just say bluntly if we allow the lobbyists and the press culture of this city and the bureaucrats of this city to guarantee that we fight, we will get nothing done and we will be one more failed Congress leading to one more bitter election, and I believe there will be a third party in that campaign. I am just appalled.

Medicare is my favorite example. Medicare is a large, clunky, inefficient government system. Everywhere in Eastern Europe—we told Eastern Europeans from Poland to Hungary to Russia, large, clunky, centrally designed bureaucratic systems don't work very well; market driven systems work better. Now, I believe we can design a Medicare program which gives every senior citizen greater choice of better health care at lower cost and, as a consequence, saves a heck of a lot of money.

In some States that is starting; there are HMOs out there today which offer senior citizens prescription drugs for 95 percent of the cost of Medicare. I believe if we were creative and we were cooperative and we brought in representatives of senior citizens and we brought in doctors and hospitals and pharmaceuticals, we could explain how we can create the greatest marketplace choice. I am willing to give you, as an example, a smaller deductible if you go into a program that saves the American taxpayer rather than a larger deductible if you decide you want a program that is more expensive.

I am willing to find ways so that the average senior citizen doesn't say, "Oh, why are those politicians punishing us"! or so the interest groups can't send out mailings that say, "Let's go beat up on the politicians who don't give us what pork we want." Instead, the senior citizens will come in and say, "I like this townhall meeting. I like this proposal. I think this is actually better for me."

Now, that is such a different mindset, and I don't mind, by the way, if it is totally bipartisan. I am perfectly happy if we go in together and we sit down together and we have joint meetings and joint townhall sessions. But our goal shouldn't be to say how many groups can we punish before they rebel; yet that is the mindset of this city when you talk about balancing the budget. Who are you going to hurt? Who are you going to punish? Who are you going to cripple? It is a sick, out-of-touch culture; we have to reach beyond it to the American people and work with them.

Now, let me talk very briefly within this larger framework about the Contract With America. You have an enormous job, and I sympathize with my good friend from Florida's comment that this paper, which I frankly was sort of impressed got printed so fast, happens to have mostly the good parts. I am sure that we will find a handful of bad parts presently, but I think it is very encouraging. And I would say to the American people that to be able to contact the Ways and Means Committee and get a brandnew document called "Description of Provisions in the Contract With America

Within the Jurisdiction of the Committee on Ways and Means" is a positive first step and I would say also to those of you who are technical experts, it is a pretty overwhelming challenge to say we are going to get all this out of committee in the next 60 days or so, but let me tell you, we are going to get all of this out of committee in the next 60 days or so.

Let me make it very clear, a lot of people said to us, you can't really pass nine reforms on the opening day. We did. We are going to break on the date we announced so families can have a vacation at Easter, period. The committees are going to report and have to report in order to be able to keep that schedule. We don't want to report bad or ill thought out or hastily drawn legislation, so we are going to start hearings at the earliest date in the history of the Congress. We are going to ask our witnesses to come and be very prepared, and be very tough-minded, and they are all going to be open to improvement.

We don't think that we wrote in stone. We thought we had in September some good ideas. That was months ago. The world changes. Those ideas give us a direction. We have five very major ideas in this committee: First, the American Dream Restoration Act, which looks at the family tax credit, at the marriage penalty tax relief, at the American dream savings account. Let me say I would hope this committee would also openly look at the President's ideas.

I think his new concept of encouraging people to get better educated, to recognize that intellectual capital may be a key to the information age, I hope you will very soon have the administration come up to testify. I would like to try to find a way to accommodate it if we can. I don't think we should reject out of hand an idea just because it comes from the President. We ought to look at it.

Second, the Job Creation and Wage Enhancement Act, with things like capital gains relief, neutral cost recovery, expensing of small business, increasing the estate and gift tax, the home office deduction. I want to make two key points here. One, if you don't have a job, having a tax credit for the American dream doesn't help you much. Two, having a job, as Ronald Reagan used to say, is the most important social program there is, and if we are going to be in the world market, we had better have the best jobs in America and so this particular bill becomes a very important vehicle for redesigning the American Tax Code to create the best jobs in the world by liberating entrepreneurship.

I will say to all of you, capital gains is often an intellectual-liberal battle. Liberals say, oh, it is terrible. You are going to help the rich. Conservatives say we need it and nobody can explain why.

If you will, bring in the biotech industry, and you will let them tell you what not having access to capital has cost in jobs in America in the largest job-increasing industry in the country. Let them tell you what is happening to foreign countries buying American biological breakthroughs because we don't have the capital here to create the jobs and create the companies. Let them explain to you the factories they would like to build, the products they would like to have, the opportunities that are forgone, I think it will begin to be obvious to the American people that we are talking about the key to the 21st century when we talk about creating enough capital to build enough factories to have enough research and development to have enough products to dominate the world market. And that, by the way, is an area where we are currently totally dominant, but the absence of capital may mean we will lose that domination by the end of this decade.

Third, the Senior Citizens' Equity Act, which looks at increasing the Social Security earnings limit, repealing the Clinton tax increase on senior citizens, instituting the tax incentives for long-term care insurance, and accelerated death benefits. Let me make a point here again. If the society sends a signal that working all your life and saving and being prudent and being frugal is stupid because we are going to take away your savings to give it to your twin brother or twin sister who did nothing and therefore throw themselves on the State, I think we send a very, very destructive signal. And when a society says to senior citizens at a time when we all know we are living longer, "We are going to punish you if you stay at work, even though we know that when you stay at work you are healthier, you are more active, you are less expensive on Medicare, and by the way, you are earning a living and paying taxes, but we are going to punish you and send the signal to quit working," I think those are exactly the wrong signals.

Fourth, the Family Reinforcement Act, refundable tax credit for adoption, refundable tax credit for home care of the elderly. There are a number of steps at strengthening and rebuilding the family that aren't speeches about Murphy Brown, they aren't arguments about orphanages. They are practical, common sense. Why are we punishing people who are doing the right thing, and why don't we want to send the economic signal to people to do the right thing?

And finally, the Personal Responsibility Act which looks at work requirements. It cuts welfare spending, it attempts to reduce illegitimacy, and it looks at restricting welfare for non-Americans. I just think we have to engage in an honest discussion, and I indicated yesterday that I hope in the next few months that virtually every Member who represents a poor district will match up with somebody who represents an economically better off district and that we will have a genuine bipartisan effort to educate each other and to really open a dialog.

I don't know what the details are. We have a bill we think a lot about. The Governors, as you all know, are very excited, and have their ideas. I think in the next few weeks—the President has already indicated a strong interest in working together on this—we should be able to craft a bold new direction on welfare reform, and we should be able to start the move from dependency to independency and back to behaviors that work in America, and I think that you play the major role in getting that done.

I appreciate your patience with me. I will just say in closing, this Contract never leaves my coat, whichever coat I have got this is with me, and I just say that to say, we are going to get this done. It is going to happen, we are going to get the votes on the floor. I believe we are going to pass almost all of it, but we are going to pass it the way we did yesterday. If you look at yesterday's votes, I am very proud of the fact that on virtually every vote we had an enormous bipartisan majority. We had from 23 Democrats—and I think that was the smallest vote for a Republican proposal—up to unanimous on both sides of the aisle. I would hope as we go through the hearings and the markups and the rules process that we could design a procedure where, on virtually every bill in the Contract, there is a strong bipartisan majority. It would be a procedure where the President can work with us in such a way that when it gets to the White House, after, of course, going through the other body, that the President will feel comfortable signing it because we will have worked together to cooperate in doing good things for the American people. Let me now just throw it open to questions, Mr. Chairman.

Chairman ARCHER. Mr. Speaker, thank you very much for taking your time to come and launch the official discussion of the agenda before this Congress. I will waive my right to question and recognize Mr. Crane for his questions.

Mr. CRANE. Thank you, Mr. Chairman, and thank you, Mr. Speaker. I am uplifted by your presentation.

Chairman ARCHER. Would the gentleman suspend for a moment? Considering the time constraint which the Speaker has to live with, I would like to alert every member that we will attempt to limit the questioning to 2 minutes per member so that we can cover more members. That has been agreed to by the ranking minority member.

Mr. CRANE. Very good. I commend you for your recognition of the fact that as a former history professor, which I was, we are at an epochal turning point in the history of this Republic. I commend you also for your recognition that this has nothing to do with Republicans and Democrats, but all Americans.

I spoke to a college Republican convention one time a few years back in Illinois, and I told the kids in describing my district, it was the fastest growing in the State of Illinois. And they said, well, aren't you right next to Chicago, and I said, yes. And they said, well, don't you shudder, those people have to be coming from Chicago. I said, yes, but kids, I grew up in the old neighborhood in Chicago, and your typical city Democrat is, first of all, a God-fearing person. Second, he believes in family and traditional values. Third, he believes in the work ethic and finally when the country goes to war, he is trying to jump in front of you in the line to enlist. And the kids said, didn't you just define your basic Conservative there? I said, no, your basic American, but you are born with two very intense loyalties, the religion of your parents and the politics of your parents, and it is hard to in effect turn your back on the faith of your father.

I think we can join in a bipartisan effort to change the direction this country is headed, and focus on two of, to me, the most disturbing things that have been going on in my experience here. One is that escalating national debt, out of control, and two, the destruction of so many of the traditional values upon which this Republic was founded. So I salute you, look forward to working with you, Mr. Speaker, and I think we can cooperate toward guaranteeing we leave something better for our kids.

Chairman ARCHER. Mr. Gibbons will inquire.

Mr. GIBBONS. Mr. Speaker, I am sure it pays for the country to have a visionary like you, but I want to try to get us down to the nitty-gritty of what we are talking about here. Your Contract has been scored by the Treasury Department as losing revenue of $712 billion over a 10-year period. I haven't seen any other scoring estimate on it, so I would have to accept these as being correct.

How within the 100-day period, are we going to proceed in this committee to reduce the stream of revenue by $712 billion, almost three-quarters of a trillion dollars, add it to the $4 trillion debt we have now, and make sure that the spending cuts that you talk about in gossamer terms are going to take place? I will not go down the road again, having once made the mistake of voting for tax reductions and just taking an empty promise that we are going to get the spending cuts.

The SPEAKER. Let me say, first of all, Mr. Gibbons, I agree with your premise, that I think we should, in fact, pay as we go and if anything, pay more than we need. Also, I think Mr. Kasich, the Budget Committee chairman, was very clear I think last Sunday on the Brinkley show in saying that we ought to cut spending first.

Now, I haven't seen the Treasury estimate, but I want to make several comments about Treasury estimates because I have worked with them over the last 16 years. First of all, I believe if you check, all Government estimates were explicitly wrong on the Jimmy Carter capital gains tax cut, literally wrong to such a degree that it wasn't a question of scale. They had a negative number for their estimate when it was a positive number, so they were saying it will cost us money if we cut capital gains under Jimmy Carter, and in fact we made money. Now, I would just suggest to you that that is not an unusual situation.

Second, the boat tax, I believe, was explicitly scored wrong. Both the congressional and executive branch estimators said the boat tax would raise money. In fact, the boat tax destroyed the boat industry, killed businesses, laid people off, cost us money, and was a net loser, so if you are saying to me that the same socialist mentality bureaucrats who have been consistently wrong were wrong again, that is possible, but I want to make a third point about the years you used.

One of my frustrations, and this is not partisan, I mean I was as frustrated under Reagan and Bush as we will be, I am sure, with the current gang down at the Treasury Department because they don't change. They are the same technicians. They pick whichever year you lose money. If they say let's do 5-year scoring, we say terrific. We will come in with a back-ended IRA. You will make a huge amount of money in 5 years. They say, oh, but you will lose money 20 years from now.

If they come in and say, well, let's score over 20 years, we will come in with a current IRA and you will gain money in the short run, whichever way you want to go, they will count it against you, so I just think we have to recognize there are some people in this city who have a passion for more money for Washington and less money for America.

Now, if we sit down and we can't solve that, then we may have a big problem. We will have a fight on the floor, but I will tell you flatly, I believe you can find honest estimates and not just by one or two people who for ideological reasons fudge. We can find honest estimates we can broadly agree on, and we can find a way and we can reshape the bill to work within those honest estimates. Thank you.

Chairman ARCHER. Mr. Thomas will inquire.

Mr. THOMAS. Thank you, Mr. Chairman. I want to thank the Speaker for once again indicating that ideas are not just important, they are essential, and that what we are largely talking about in his five goals is an examination of where we are and where we need to go in terms of prioritization. There is no question I can ask in a 2-minute period or you can answer that would expand beyond your opening statement and therefore I yield back the balance of my time.

Chairman ARCHER. Mr. Shaw will inquire.

Mr. SHAW. Thank you, Mr. Chairman. I would like to congratulate you, Mr. Speaker, on a very good opening statement. I think you hit some hot buttons, particularly as to the negative effect that many of our laws have upon the goals that we would like to accomplish, both Republicans and Democrats, and I would like to dwell for just a moment on welfare.

Your figures, I believe, are quite right as far as the earned income tax credit and how we penalize marriage, but we tell young people, particularly a young girl, that you can have a child, not get married, not go to work, not live by any of the other rules, and we are going to have a package for you that is worth anywhere from $12,000 to $16,000 a year.

On the other hand, you can go to work, earn minimum wage and not quite get up to $9,000 a year. The system is totally backward. I think we have put together a very compassionate welfare reform package, and I think the President has correctly enunciated some of the basic principles that are in our package, and hopefully we can work together. Some of the details that we are going to argue about, unfortunately, are going to be the details that will be making the news, but I think the cruelest welfare system of all is the one that we already have in place—paying people to stay in their place, not to succeed, not to break out.

I think you made the point very well yesterday in looking at some of the words from the "Battle Hymn of the Republic" on what is freedom. Someone living on welfare is not free. They don't even have the basic principles that we guarantee as far as the rights of basic Americans, of basic citizens, and we are going to make that happen.

I have spoken to many of our colleagues on the other side of the aisle who are going to be on my Human Resources Subcommittee—many of whom who are on this committee aren't on that committee—who want to help and want to get involved, and I am going to be meeting with members on both sides in order to try to determine where we come down together and where we are going to agree to disagree, and move that process forward, and I will tell you that we on our side, on the Republican side, we are committed to delivering on the Contract, and we are committed to the time that you have set, and we are going to be here on Mondays and Fridays working very, very hard because the full committee is taking up Tuesdays, Wednesdays, and Thursdays, and we are going to be here next week working and starting the hearings, and we are going to deliver on that Contract, and I appreciate the leadership that you have given in pushing this forward as one of the major planks. And I feel that it is the most major plank that we have in our Contract With America.

If we are truly going to change America as we would see it, we have got to bring everybody along, and we cannot leave people enslaved by a system that has broken down and encourages people not to succeed, and I thank you for your leadership.

The SPEAKER. Can I make two very quick observations? I know—I don't want to use up the time on this, but I want to use this as an example of how different we could be because I want to go back to Mr. Gibbons' correct point. There is no reason in a budget-neutral way that we could not redraft the earned income tax credit to simply provide that we will reduce the amount available for individuals while expanding the amount available for couples so that you at least get the same, you get two times individual, do it all on a budget-neutral basis and at a minimum have eliminated the antimarriage penalty.

That should be something that the staff could do in 1 week if you want to. You could do it with no budget consequences, so, first of all, there are ways to rethink how we do things if you are willing to do it.

Second, I would be very interested, and I am using this as an example for a whole range of bills, and I am not in any way trying to preclude the Chairman's leadership, but I want you to think about this possibility. Rather than get into our classic tax fight where somehow we produce massive bills and the minority on either side has to produce a bill and then each side's lobbyists get together, then there is a big brawl, then the President vetoes it, let me suggest if we could agree that an antifamily earned income tax is stupid. We could agree that a budget-neutral way of reforming it would be smart, and if the President and Senator Dole and Senator Daschle would agree so that they would protect the bill as written, I would entertain, if the committee came and asked me to, as Speaker, bringing a bill like that in as a very narrowly drawn bill, widely supported on both sides and pass through—not to be used in the Senate as a vehicle to send us back a bunch of stuff, but with an agreement in advance that it would go through the Senate and be protected by both parties and get to the President and be signed. We would literally early this year make the earned income tax credit no longer antifamily.

Now, I don't know if that is good or bad. I am just saying today, it is a way of thinking about trying to get to some reform and some solutions that could actually be signed into law quickly and not just degenerate into a partisan fight, and I thank you for raising your point, Mr. Shaw.

Chairman ARCHER. Mr. Rangel will inquire.

Mr. RANGEL. Thank you, Mr. Chairman. Mr. Speaker, yesterday your speech raised a lot of eyebrows in the press and throughout the country and people were shocked, surprised, some were even critical because they had never heard you express such sensitivity to the plight of poor folks in this country, and even today you pointed out that as America moves forward you would want to make certain that at least as a part of everyone's dream those that find themselves in this city, that they are part of that. It is reachable, that it can be done.

Throughout the Contract and the rhetoric of the campaign, it seemed as though the Republicans were able and far more effective than Democrats in pointing out the frustration of American people in wrestling with these problems, and that is, the problems of children irresponsibly giving birth, children shooting each other in the street, the problems of crime, AIDS, violence in jails, and so forth. So, as we move forward in this global economy, we face now 1 million people in jail, 1 million people waiting to get in jail, 1 million people under some type of control. Yet the answers in the Contract look like, well, cut off the checks and get more cops and get more prisons and show that we won't tolerate it.

When you said we expect more from the private sector, we are getting closer to reading from the same page if what you are really saying in addition to what you have said is that the private sector has a responsibility to tell us what that work market should look like. The private sector has a responsibility to be working with our schools and educational institutions to make certain that not only will the kids be able to read this diploma, but will be employable because it is the private sector that dictated what these needs are.

It would seem to me that as we reach out in asking them what we should and should not be doing to remove regulations and tax impediments for them to succeed, that if we can agree that we can look at the poor very much the way the Army looked at me when I was a high school dropout. They did not ask me what kind of job I wanted. What they did was tell me what had to be done and once I found out that I could do it, I was excited about the job, and I succeeded.

I do hope that we can go beyond the Contract which somehow doesn't really give those incentives for people to stay in school, to know they are going to have a job, and to be working but rather deals mostly, from what I see, with those Americans, poor as they may be, minority as they may be, that are falling between the cracks. I look forward to working with you to see whether we can get a full contract for all Americans.

The SPEAKER. Let me say very briefly, first of all, I think we are very close to the same page. I don't know if that is because you have on occasion gotten the Republican nomination in your district and there is really this secret compatibility, but there is no question that in many ways in our conversations over the years we are very—we are much closer than our debates and our votes sometimes imply.

As a minor example, last night I was very pleased to be able to announce at the Republican gala which celebrated our victory that we have raised at least $10,000 for Horton's kids to use in Anacostia this year in an "earning by learning" program where we go in with volunteers and we help poor children by paying them $2 a book to read in the summer and we help second and third graders in public housing. That was done deliberately to say here is a political event that is fun, but let's turn it to the good of the community of the National Capital.

I believe if we could work together and if we could work with your mayor, who I have great respect for and I think is doing a good job despite one minor slip-up in October, I think that we ought to be able to pick up on exactly what you just said: How do we ensure that we have the incentives to stay in school, how do we ensure that there are jobs in that neighborhood when they get out of school, and I think we would go to the people. And that goes back to my other point, for example, the biotech companies.

We have one district in your city whose largest single employer is a pharmaceutical company. Now, to adopt a Tax Code and a regulatory code which drives that pharmaceutical company to go to Germany thereby closing the largest single manufacturing facility in that congressional district is irrational if you want the people of that district to have jobs. I would like to work with you and I know Chairman Archer has a deep desire to work with you, and I can just assure you in the Speaker's office we will do all we can to shape a full contract for every neighborhood and every community in the country.

Chairman ARCHER. Mrs. Johnson will inquire.

Mrs. JOHNSON. Thank you, Mr. Chairman. I just wanted to comment on a statement that you made, Mr. Speaker, because it is something that this committee is already aware of, that some in this city want us to do stupid things and fail. There is a certain truth in that, but also our process sometimes encourages us to do stupid things that force failure, and as we go into this, your admonition to think big, to think beyond the dots and beyond the lines is the only way we can avoid the kinds of failure that our own process has forced on us in recent years. I want to thank you for that comment, but I am going to yield back the balance of my time because I would like my colleagues on the other side to get through their questions. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Stark will inquire.

Mr. STARK. Thank you, Mr. Chairman.

Mr. Speaker, I do have an area which I think we might want to talk about redrafting. In your Contract, the bill called the Senior Citizens' Fairness Act, or, as I think you said, Equity Act, helps high-income individuals by repealing the 1993 increase in the amount of Social Security benefits subject to tax.

The 1993 change applied only to the 13 percent of the wealthiest beneficiaries. That change would increase the deficit by $15 billion over 3 years. The Republican estimate was $17 billion. We think it is a little lower. And because the revenue generated from the 1993 increase was dedicated to the Medicare Trust Fund, you are in effect increasing the income of 4½ million upper-income beneficiaries and cutting Medicare for the remaining 30 million Social Security recipients with low incomes.

I hate to suggest taking from the poor and giving to the rich, but in effect you are giving $15 billion to this upper-income group and taking the $13 billion in effect away from the 87 percent with the lower income.

I think that this may have been unintended, because quite frankly, when the Contract was drafted, someone may have overlooked the fact that that money had to go into the Medicare Trust Fund.

Would you encourage us to rewrite this portion of your Contract to protect the low-income beneficiaries from this Medicare cut?

The SPEAKER. Well, let me say first of all, Mr. Stark, since I am not on the committee and I am not an expert, maybe you can help me and the country understand. When you talk about increasing taxes on upper-income retirees——

Mr. STARK. Lowering them.

The SPEAKER. What is the level at which it became upper income? Where did this tax increase go into effect?

Mr. STARK. Well, it is $44,000 for families, which, as I say, is about 13 percent of the——

The SPEAKER. $44,000 per family, and what was it for an individual?

Mr. STARK. That is where it starts. The median is probably closer to $80,000 or $90,000. The 30 million under that, the median is about $7,500 a year.

The SPEAKER. See, what we said was that in effect $44,000 for a couple, you are now rich enough that since we don't have the courage to directly means test Social Security and take it up front, we will simply steal it from you from the back door by raising your taxes.

Mr. STARK. But for the poor people, you are going to cut Medicare——

The SPEAKER. I am not necessarily going to cut Medicare. We don't agree on the initial definition. You may think $44,000 is upper income. That may explain why the——

Mr. STARK. I am happy to support any tax cut you want to make. I am just saying, do you want to do it by cutting Medicare? Is that your intention?

The SPEAKER. Not necessarily. But let me make two points. First of all, the last, I think, three Republican budgets have proposed that at the $100,000 retirement income, senior citizens do not have to be trapped into Medicare against their will, nor will we subsidize them if they decide they want to buy Medicare.

So we were prepared to say at the $100,000 income level, in budgets that I voted for, at least, that you could buy your own health insurance, you could buy Medicare, unsubsidized if you like, or if there is a better plan at a fully unsubsidized rate, you can buy it.

But we were prepared in that sense to approach the Medicare question in a way which directly affected—we thought $1,000 was closer to being a serious number than 44, but to begin to say to people at a fairly high income level, why should we tax the $20,000-a-year person with a family of three to transfer the subsidy to a multimillionaire?

So I am prepared to look at ways that change it. But second, I want to go back to my other point because maybe it wasn't clear, or maybe I didn't make myself clear.

Mr. STARK. The question was, Mr. Speaker, do you want to cut Medicare by $15 billion?

The SPEAKER. That is the second point I want to make. It is my understanding that we have a Medicare option available only in 15 States which allows people to take an HMO at 95 percent of the Medicare average for that State, which means by definition every citizen who decides to take a Medicare HMO in that State is saving the taxpayer 5 percent of the average cost of Medicare.

Now, if you were to say to me, if I found a good enough package that voluntarily enough senior citizens wanted to improve their options, and in the process they saved $13 billion, would I be willing to take the savings that they voluntarily gave back to the government because the market gave them a better option? Sure.

If you are saying to me, am I going to punish senior citizens, the answer is, of course not, that is silly, we are not going to do that. And if that is not the way we pay for it, we will find some other way.

I certainly want the committee in its hearings to explore all the options and not do something which would be dumb. I agree with you: We should not be dumb if we can afford it.

Chairman ARCHER. The gentleman's time has expired.

Mr. Bunning will inquire.

Mr. BUNNING. Thank you.

Mr. Speaker, it is good to hear from you, it is always enlightening.

On the Senior Citizens' Equity Act, there are some other provisions in the act that are in my opinion probably the best ideas that we have seen for senior citizens and for people to get back into the marketplace. After we force our senior citizens to become inactive after the age of 65 by the Tax Code, we can do away with the Tax Code and do away with the money. We would all be better off.

Do you do your own taxes or are your taxes done by a public accountant?

The SPEAKER. I want to confess up front I lack Mr. Archer's courage. I also want to confess up front that it is basically all handled by my wife who hands me a document from a CPA which I sign.

I also want to say up front, I can say this without sounding too defensive, that given my track record and my public disclosure and my media relationships, I would be an idiot if I did my own taxes because I need a CPA and a tax lawyer to stand next to me and say, Yes, it is OK.

But I agree entirely. I was going to mention earlier, I feel very badly I didn't mention it, that I would hope once you get beyond the Contract, you would have hearings both on Mr. Armey's flat tax concept, and on the Domenici tax approach. I would hope you look in an aggressive way.

I was very cheered 2 or 3 days after the election when Chairman-elect Archer said to the national press that he intended to very aggressively look to getting to a simple, direct Tax Code.

You mentioned something that is a good example of where Mr. Gibbons and we may have a debate later on, or he may decide we are right. If you do not take into account changes in behavior, lowering the tax penalty for working costs the Federal Government a lot of money in terms of Social Security.

That is, if you allow senior citizens to work and you don't punish them, but you don't take into account the fact that more of them will work, the Treasury can come up with some horrible number about what it costs us to allow people to keep their own money and work.

On the other hand, if you have any assumption, and this goes back to the boat tax example, where Treasury was totally wrong and totally destructive and killed thousands of jobs, and if you say, "Gee, if we allow senior citizens to keep the money if they work, they may pay tax, including Social Security tax, you get a totally different number for what that costs.

There ought to be some bipartisan way to set up a panel of experts who are not trapped into a Socialist mindset and find the kind of solution that I think you would agree with that gets us there.

But I appreciate your raising it. I think the Code should be simpler. I think we should encourage people to behave in ways that are healthy. And I believe in the long run the country will actually make money from those kind of changes and not lose it.

Chairman ARCHER. Mr. Houghton will inquire.

Mr. HOUGHTON. Thank you.

This is going to be very brief, Mr. Speaker, because I would like to relinquish my time to others on the other side. I think the bind is going to come in making the arithmetic work out, because when you basically cut taxes, increase military, and then cut spending, the basic spending cuts have to come from the discretionary account, because you can't touch interest, and you are not going to touch Social Security, and you are probably not going to cut very much out of Medicare. And probably defense is going to be touched a bit. That falls on a third.

And so when you take the arithmetic of balancing the budget with all those things, and level it on that discretionary or that third of the amount of money we spend on our expense account, it is going to be a difficult task, and that is what we are going to be facing. But I wanted to share that thought and that worry with you.

The SPEAKER. I agree.

Chairman ARCHER. Mr. Jacobs will inquire.

Mr. JACOBS. Mr. Chairman, I have a gift for the Speaker and for the committee. I pass.

The SPEAKER. I accept my preemptive Christmas gift and I thank Mr. Jacobs.

Chairman ARCHER. Mr. Herger will inquire.

Mr. HERGER. Mr. Speaker, I want to join in thanking you for your leadership, for your ideas. It is the greatest breath of fresh air I have seen in my tenure here in Washington. Again, I commend you.

You have been out to my district in northeastern California which contains some 17 percent of the land area of California. It is very rich in agriculture and produces many wood products. My concern has to do with the vast majority of businesses in our district, which are small family businesses, like so many throughout the Nation. I worry about their ability to transfer these businesses from parents who have worked hard all their lives to their children who have been working with them.

Statistically, in our district and in the Nation, some 67 percent of all small businesses do not survive that first generational transfer because these businesses do not have large liquid assets, whether it be in cash or whatever, with which they can pay these large Federal inheritance taxes. Therefore they are forced to sell these farms and businesses in order to pay the taxes.

My specific question is, how will the provisions in the Contract With America that increase and index the estate tax credit help these small family businesses need to survive the transfer between these generations?

The SPEAKER. Well, I think that is one of the reasons, frankly, we put it in. We felt there were three powerful reasons for encouraging people to be able to work very hard and be successful. The first was to strengthen family ties, to say to people, We think it is a good thing if you try to help your family, we think it is a good thing if you care about your children and grandchildren.

The second was to recognize if you really want to have capital accumulation, if you look at those countries which have had very rapid growth rates, they almost all have strong extended families in which the families acquire the capital over time. It is very important to have a dynamic model where you are thinking about time, and something that 1 day is not very powerful, over 10 years, may become extraordinarily powerful.

And so we have until now adopted a very anticapital accumulation, antifamily business, antientrepreneur attitude which punishes those who have worked the hardest and tried the most in order to achieve things.

Last, I think our approach to this is to say that the government should not intervene in a way which destroys a local community. When you set up a situation where a family suddenly learns that basically in order to pay the Federal Government they ought to sell their company to a Japanese company or to a German company or to some other country where they have capital because they have more savings, they have a better Tax Code for capital.

And you are in effect disinvesting America of its own ownership because your government now punishes those families that worked so hard for their children and grandchildren. We think there is something profoundly wrong, and that is why we want to pursue those kind of changes.

Chairman ARCHER. Mr. Matsui will inquire.

Mr. MATSUI. Thank you, Mr. Chairman.

I want to congratulate you, Mr. Speaker, for your election yesterday and I appreciate the fact that you are here today. We appreciate your testimony. Two minutes certainly doesn't give us enough time to analyze the Contract With America. But just to underscore the lack of time and the inability to really delve into this, you mentioned, for example, senior citizens and the wage cap and the fact that if you lifted it they would find more opportunities for work and therefore there might be a positive dynamic impact on the economy.

One of the reasons the Joint Tax Committee never scores that as a positive revenue impact is because there is another impact, too, and that is that you may displace some others who are moving up into the job market. Getting into macroeconomic policy by making a microeconomic change is a very dangerous game. I hope all of us will be very careful when we do this.

Another example: You mentioned the marriage penalty, which obviously we would all love to change. Mrs. Kennelly attempted that last year, but it was estimated to cost $70 billion in taxpayer money in order to make that change over 5 years. Your Contract provision only deals with $10 billion or one-seventh of that particular problem.

Let me conclude, because I don't want to take any more time. I would hope that you—and I am sure you have—would review the book written by Dave Stockman, and particularly page 98 where he talks about rosy scenarios. I recall that I was here when you were here in 1981 and we did do the Reagan economic plan. This book talks about those that were the ideological fathers of the Reagan supply side economics; Paul Craig Roberts, Norman Ture, Steve Entin, Art Laffer, Jude Wannisker, Jack Kemp, and Lou Lehrman.

Many of those same people are behind and had input to the Contract With America. I just hope that they are not as wrong this time as they were in 1981, when we had the massive deficits, as the ranking member, Mr. Gibbons, has talked about. Last year we went through a lot to get that deficit at least starting the trend line down over the next decade, with a view to continuing that trend well into the next century.

For us, now, to eliminate that budget discipline will result in more pain for the average middle-class taxpayer because their interest rates will go up. They are the ones that borrow in this country, they are the ones that will really pay for any kind of undisciplined activities we take over the next 6 months or so.

The SPEAKER. Let me commend you first of all for getting a lot into 90 seconds. I will try to match you, at least in brief comments, in about 40 seconds.

First, I agree with the need for fiscal discipline. That is why, for example, with the earned income tax credit, I suggest we find a revenue-neutral way for eliminating the penalty for getting married.

Second, we are aware of the fact that the marriage penalty replacement would be expensive. That is why we suggest gradually phasing it in. But we think by setting a pattern of phasing it in, we are at least moving gradually in the right social policy.

Third, I believe that the Reagan tax cuts, without any question, increased the size of the American economy. We doubled the revenues of the Federal budget in the eighties. When you go back and look at the numbers, the revenues went up. Now, the Congress then had no fiscal discipline, and so we managed to increase spending at a rate even faster than doubling the revenues during the decade.

But look at 17 million new jobs created; look at the capital investment which allowed Ford Motor Co. and others to be competitive in the world market; look at the explosion of the biotechnology and computer industries, look at the fact that we retook our advantage in computers back from the Japanese; it was a very powerful period of economic growth. That doesn't mean we in the Congress don't have an obligation to have fiscal discipline.

But, finally, I want to say one last thing. Mr. Stockman wrote an interesting and sadly cynical book about the fact that he couldn't dictate to the U.S. Congress. He couldn't dictate to the U.S. Congress because he wasn't prepared to start with the first premise, which is a dialog with the American people.

I was in a lot of those meetings. I watched that system break down. That is the reason I am suggesting to us here today, we have to have a different approach. You cannot get to a balanced budget on the current structure of this government. It is impossible. You have to rethink the entire structure to get to a balanced budget.

Stockman was not prepared to do that kind of very deep thinking, and he wasn't prepared to be honest and open with the American people. And you cannot in the long run hoodwink the American people into changes they don't agree to.

Chairman ARCHER. The gentleman's time has expired.

We have time for one last questioner. Mr. McCrery will inquire.

Mr. MCCRERY. Thank you, Mr. Chairman.

Thank you, Mr. Speaker, for sharing with us today your vision for the future of this country and the change in direction that you think we must head.

Beyond the very important things that we should have gleaned from your vision, you also said something very important of a very practical nature, and that is that the Contract With America and the legislation that backs up the Contract With America is not written in stone. In fact, it is going to be a dynamic process. We can add to it, we can subtract from it, we can alter it, we can modify it, and that is good news for those of us on the committees of jurisdiction, and it is good news for the American people, I think.

One thing, for example, I think we ought to add to our welfare reform package is reform of the SSI disability for children program. It has tripled since 1990, since the Supreme Court decision. We need to correct the Supreme Court decision or correct the incentives in the system that caused it to bloom.

Also, with respect to welfare reform, I like your analysis of the consultants causing us to think outside the dots. I think we ought to start thinking outside the dots in a lot of areas of public policy, and particularly our welfare system.

For example, rather than starting with the current system and try to modify it, as President Clinton has done and as we have really done to a certain extent, why not reject the system as it exists now, start anew with the premise that welfare should only be given to people who are truly unable to care for themselves, they are disabled mentally or physically, and to people who work. Start with that premise and build a system off of that.

If you do that, then you end up with an EITC, a disability program and an unemployment compensation program. That should be our welfare system, put very simply. We can think outside the dots. We should. We should scrap a lot of what we are doing now and start anew.

With respect to the Medicare cuts: Mr. Stark, my good friend from California, knows very well that we have cut Medicare consistently through the latter part of the eighties and into the nineties. What he means by that is we have cut the growth of Medicare. We have never cut in nominal terms what we spend on Medicare, what we spend on the elderly. We have only cut the rate of growth. And the example he gave is exactly that, only cutting the rate of growth, not cutting Medicare.

And he also knows that every time we have cut the rate of growth in Medicare spending, those cuts have fallen not on the elderly, but on the providers in the health care system. And I am sure that that will continue to be the case as we try to downsize Medicare.

I, for one, hope that we can cut Medicare some more. We are going to have to if we are ever going to get this budget into balance. Again, when I say cut Medicare, I am saying we need to cut the rate of growth and spending in the Medicare program.

The SPEAKER. Can I just say one or two quick things in closing? I want to build on what Mr. McCrery has said.

First of all, I don't know that I would ever use the term "cut Medicare." I think we need to transform Medicare into a different system. And I think it is nonsense for us to talk about a system which is highly bureaucratic, extraordinarily expensive, and in many parts of the country now is beginning to actually offer a lower quality of care as doctors begin to withdraw from it because they don't want to deal with the redtape and they don't want to deal with the Health Care Financing Administration. And so senior citizens are finding it harder to get good care because the Federal Government is making the system unworkable.

So I don't know that I want to increase or decrease what I think is a system that needs to be transformed, that needs to become different.

Let me build on that at two levels, and I will close on this, but I really commend this to all of you. First, I mentioned yesterday Marvin Olasky's "The Tragedy of American Compassion." Olasky goes back for 300 years to how we dealt with people who did not have money and people who needed care and needed help. The book is so radically different than anything I expected to read. He describes an America that was more effective at helping individuals in trouble and was constantly blocking itself from creating classes of people who were entitled to money.

When you read quote after quote for 250 years of active philanthropic reformers saying, "Don't set up a class structure where people are entitled to money or they will find a way to get the money, and they will change their behavior in ways that destroy them," it is the most staggering indictment of our current structure.

The one thing I didn't agree with my good friend Mr. Houghton about is, except for Social Security, which I think should be off the table because I think it will tear us apart to deal with it, I believe there are no other entitlements that do not deserve to be looked at and transformed. And I am not afraid. As I said yesterday, I am an FDR Republican. We have nothing to fear but fear itself. I want to have a public dialog about these things.

Mr. Archer knows full well, and I would encourage you to have both Democratic and Republican Governors come here and share with you the courage they have had: Talk to a Bill Weld who cut spending by 13 percent in 3 months; he got 71 percent of the vote getting reelected because people thought about it and decided they liked smaller, more effective government better than bigger, less effective government; I talked to a John Engler, who changed the system in Michigan and got 70 percent of the vote. And it is not just Republicans, Democrat mayors like Rendell in Philadelphia, who changed the structure of Philadelphia, or Norwest in Wisconsin, or talk to my Democrat Governor Miller, and these leaders will tell you, if you have the courage to look the American people in the eye and tell them that it makes sense to do it better, we can dramatically change the size and shape of this government.

And that is the way I would like to approach it, not timidly, backwardly, not in the closed room, not afraid, but walking out in public and saying to the American people, "Your children and grandchildren are going to have a balanced budget, a better government that is more effective, that delivers goods and services better and that, where possible, helps every American pursue happiness by having the best paying jobs in the world."

That is our challenge. It is a hard challenge, and I simply say to my Democratic friends—and I apologize, I have got to go to another meeting—but as I said to the President this morning, and it was a great meeting, we will reach out, we will work together. I believe we can get most of this Contract, virtually all of it passed, and I believe if we work together, it will be good for America.

Thank you very much, Mr. Chairman.

Chairman ARCHER. Thank you for giving us your time out of your busy schedule, and for your vision and for your presentation.

With apologies to the members who were denied the opportunity to inquire because of the constraint of time, I do think we should be grateful to the Speaker for the time he has given.

When we adjourn, we will adjourn until 9 a.m. on Tuesday morning. Normally we would hold our hearings at 10 a.m., but a number of Members of Congress wish to testify, and in an attempt to accommodate them on Tuesday, we will begin at 9 a.m.

The committee is adjourned.

[Whereupon, at 2:35 p.m., the hearing was adjourned.]

CONTRACT WITH AMERICA—OVERVIEW

TUESDAY, JANUARY 10, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 9:05 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

Chairman ARCHER. Today we begin the second day of overview hearings on the Contract With America. Last week we heard from the Speaker, Newt Gingrich, and today we will hear, first, from the distinguished Minority Leader Richard Gephardt, followed by Secretary of Health and Human Services, Donna Shalala, other Members of Congress, and from Les Samuels, Assistant Secretary for Tax Policy with the Department of the Treasury.

In addition to items under consideration by the full committee, the subcommittees are having their hearings, and when we are finished, we will have heard from hundreds of witnesses on all of the details that are included in the Contract.

The Contract and the five related bills that are subject to the jurisdiction of this committee represent a powerful agenda to get America on a positive track. I call it an agenda for the next century. And while the Contract's main principles of less government, less spending, lower taxes, and more freedom will not be changed, we are holding these hearings so we can benefit from the very best ideas of the American people and their representatives. And we do welcome and should welcome new ideas and thoughts.

As I have stated before, I intend to carry out the taxpayers' business of this committee in a bipartisan manner. I believe the American people will benefit from the best ideas from both parties. No party has a monopoly on good ideas. Our work is important and listening carefully to each other is equally important.

Dick, I welcome you to the Ways and Means Committee and I look forward to your testimony, but if I may, prior to hearing that, I would like to recognize my friend and the leader of the minority of the committee, Mr. Gibbons, for a statement.

Mr. GIBBONS. Thank you, Mr. Chairman. I am going to yield to Mr. Rangel, who will make a statement for us.

Mr. RANGEL. Thank you, Mr. Gibbons.

Mr. Chairman, thank you for the bipartisan way in which you have started the operation of this committee under your chairmanship, and I look forward to working with you on the agenda for the next century. It is going to be exciting for all of us to see how we can dramatically reduce capital gains taxes, move forward into the next century as the leader in trade and the global economy, and, at the same time, manage to see what we can do for the jobless and the homeless and the hopeless people in this country.

Right now we have over 1 million people in jail, 1 million people waiting to go to jail, 1 million people under some type of court supervision, and we also find millions of young children being born to irresponsible parents into poverty, destined to live in poverty, and their children to follow them. And so, when Republicans and Democrats and the American people focus on this, it is interesting to see that one of the solutions could be just to say that the Federal Government has no responsibility for this and we will pass it on to the States; another novel solution is to say that if you are 18 or younger, that the child receives no assistance at all.

An additional approach could be that if the mother cannot identify the father, then, obviously, she would not be entitled to health care or any other type of assistance. And whether she is trained for work or whether work is available, if somehow in 2 years she is not working, then certainly it is not a Federal responsibility. This is interesting because I suppose that it means that the child and the problem have disappeared, and since it bothers all of us to carry this burden into the next century, I am very anxious to see how these solutions are going to work.

So, Mr. Chairman, as we move forward together with this agenda, I do hope that when it is proven that it will not work, that some of us can come up with some constructive criticism, try to make amendments, and see whether or not for the American people we can find some solution to what everyone has identified as a real, serious problem.

Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, Mr. Rangel.

Without objection, any other opening statements may be inserted in the record at this point.

Let me say at the outset that Mr. Gephardt's testimony will be limited to 1 hour, including the questioning, and not because of him, because he is willing to stay on, but because our schedule is so full today and we need to hear from all of the other witnesses. I apologize to you, Dick, for that, but as succinct as I know you are, I think we can get a lot done in 1 hour. And having said that, we would welcome your thoughts.

STATEMENT OF HON. RICHARD A. GEPHARDT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI, AND HOUSE DEMOCRATIC LEADER

Mr. GEPHARDT. Thank you, Mr. Chairman, very much.

It is a great honor, always, to appear here, as it is today. I think it is very fortunate that much of the Contract that we are going to be considering over the next weeks is coming through this committee, which I served on at one time, as most of you know, and I say that because this committee has always had a tradition of responsibility and bipartisanship, which I think will serve us all well as we go through this very important set of issues.

I would ask that my formal testimony be made a part of the record. I would like to cut it way down and be very succinct, if I can be, so we can get to as many questions as we can.

Chairman ARCHER. Without objection.

Mr. GEPHARDT. Let me start by saying that I speak today not for the Democratic Party, although I am the leader in the House of the party, I speak as an individual and I am going to offer some ideas and suggestions that I hope will be constructive and helpful for your consideration on a number of the issues that you will be taking up in the next weeks.

We have a very new and aggressive policymaking process within our caucus in the party. It is fully engaged now and we are working to develop ideas on many of these proposals, and we will have those ideas as we go along at the proper time. But I do not pretend today to come here to speak for all the Democrats in the House. I come today as an individual and to offer some suggestions, constructive suggestions.

Let me first say that, before delving into the specifics, let me just give some of my observations about the Contract in general, and then I will get to the specifics.

First of all, I commend the Republicans for putting forward a set of ideas. I think that is a constructive way to operate. The Democratic Party in the House has always tried to do that, and I commend you for doing that. I have two worries about the Contract, and then I am going to talk about what I hope we can do with it.

The first is that even if you accept, in my view, everything in the Contract as being positive, and even if we were to enact all of it as is, I do not believe, with all humility, that it addresses directly, as we must and should, the major problems that face our society, or the core challenge that faces our society.

It is not that there is anything wrong with these areas. We do need to do welfare reform, we do need to do something about the budget, we do need to do something on taxes and on down the line. Term limits need to be considered and so on. But the core challenge that I sense in talking to my constituents is the standard of living of the American people, and especially middle-income Americans.

For a variety of reasons, some in our control, some not, in my view, the standard of living has been stuck in place or moving backward, and that has created a set of problems for families that are very serious. And it goes way beyond just the economic issues. Clearly, if people are not making enough money they have economic problems, but it creates human problems. If families are not able to be together because parents are working two jobs and on split shifts, they are not spending the time supervising children, relating to one another as a family, and doing the things that families have to do that take time.

And so this whole cluster of economic problems, which I think we are all aware of, are being compounded by becoming human problems, quality of life problems, whatever you want to call them, and I think that is the core challenge that our country faces as we move into the next century, and we have to do something about.

Some things in the Contract indirectly, some more directly, affect that cluster of issues, but, clearly, we have to do more. And I am sure everybody here would agree that once we are finished with the Contract, whatever happens with it, we have to move on to those central challenges and deal with them very directly.

Second, I have expressed since the beginning of the discussion a concern that if the totality of the Contract is enacted, that there will be very negative serious financial implications for the Federal Government's budget. We can argue about that, we can differ about that, but the way the numbers add up for me is that if we did everything as written we would wind up blowing at least a $1 trillion additional hole in the deficit, and I think that is something that this committee especially needs to be very careful about, because, obviously, that would have negative economic consequences.

Finally, I am—and I will talk in the tax section—I am worried about who gets the tax benefits and whether or not we get into a bidding war and whether we size the amount of the tax cut. I am going to talk about that more in just a moment. But I wanted to raise those concerns that I have while saying that I think any time anybody or any group in this Congress presents serious ideas to improve the country, it is a good thing, and you can be assured that the Democratic side, and I am sure the Republican side, will come forward to this debate in a constructive way and we will try to offer suggestions, as I will today, to make these ideas work better, and we ought to work in a bipartisan way as much as we can to try to approve these ideas and make them work for the American people.

Now, let me go to welfare reform and then to some of the other issues in greater specificity.

As I understand the proposal on welfare reform, as the gentleman from New York said, it has become probably a question of passing much of the responsibility for welfare to the States. I want to first submit that I do not think that anybody would try to argue that the welfare system we have is perfect or that it works the way we would all like it to work or that it could not stand improvement. Clearly, it could. The question, however, is what kind of improvement? Who do we help? Who do we hurt? How does it work? What is the outcome? What is the result?

If we make a decision that more responsibility should be pushed to the States, I think we have to be very careful about how that takes place. I think all of us believe in work and personal responsibility, but I think that we have to not just pass the buck but we have to figure out how to solve the problems.

Block grants toss the ball to the States and hope they do better, but I think we have to require them to do better. We cannot just cross our fingers and hope for the best approach.

I am not talking here about mandates. I am not suggesting that we fly in the face of another effort that we are engaged in in the Congress of getting rid of unfunded mandates. I am saying that if we are going to be contributing huge amounts of money to the betterment of the welfare system in the country, that it is not wrong for us to demand real results. Not complex bureaucratic requirements, but basic human requirements. And let me just quickly suggest four possible standards that we might think about if the decision is to give the States more responsibility.

First, we might want to say that all children and families under 90 percent of poverty should receive adequate nutrition, housing, and health care. The Speaker in his speech last week emotionally, and I think very movingly, talked about what is happening to children in our society, to some children in our society. There is not an American, I believe, who does not want to change that situation. But if we just send money to States without some sense of what we are trying to achieve, then we have really missed the boat.

Why should we not set a goal for them to reach for that says that kids in families under 90 percent of poverty should not be left out in the cold, should not be starving, should not be in grave difficulty? That seems to me to be a place to start.

I might note that protecting children is a Democratic priority on a whole host of issues: Health care, crime, education, job training and so on. So that is the first suggestion.

A second standard or requirement might be with regard to fathers. Could we say fathers of illegitimate children should be identified and either paying child support or married and part of the family? All of us believe strongly that if there are two parents available that there is a better chance that children will get a proper start and will be dealt with properly.

Why should we not encourage a requirement or a standard that States should move toward a goal which would bind families together, push families together, rather than requirements or inducements that pull them apart? Something we have talked about in past versions of welfare reform and needs to be addressed again in this version.

Third. Should we not say that a large proportion of AFDC recipients should be placed in jobs as a goal, with child care and health care for kids? Under the Personal Responsibility Act, which was an original provision in the Contract, only 2 percent of a State's welfare recipients were required to have jobs, and by the year 2003 that commitment rose to only 50 percent.

Do we really want to leave this question with States with a goal that says we are only trying to get half of the people into jobs? Why should we not go for 100 percent? Should the goal for welfare not be, as the President said in his speech of about a year ago, to get this not to be a way of life, but a way up, a way out of a system that no one really wants to be in?

Finally, could we not suggest that States have programs serving parents living in poverty to help them be better parents? We have a program in Missouri that has now been copied in most States called Parents as First Teachers. Parents as First Teachers. It is a family-based program. It tries to help parents be not only good parents but teachers. And we all know that our parents are our most important teachers throughout our life. Should we not encourage, as a goal, States to have programs like that?

We know Head Start works. There is little disagreement that Head Start is an important way to deal with youngsters who are in tough situations, who have families that are not intact, who are having learning problems, who need help. It is a way to keep children in families, not a way to separate them from families.

In the crime bill last year, I suggested an approach of getting schools to be a major instrument in helping families stay together and helping children succeed in difficult poverty circumstances. I have been to the Comer Schools in New Haven, Conn. We have Comer Schools in St. Louis. They start earlier; they go later. They have lower pupil-teacher ratios. They bring families into the school;

they send people out to get families to bring them into the schools. Some of them require that families be present in the school for a certain amount of time a week and they show tangible results. This is the important thing, tangible results, in getting better test scores, more intact families, and in helping families succeed at what they are trying to do.

At the original Comer School in New Haven, Conn., in the toughest, poorest part of New Haven, the school that 20 years ago had the worst test scores and the worst outcomes for children, now has the second best in the New Haven system. I visited it, I talked to the children, I talked to the parents, and any of you who would go there would be deeply impressed with what they have achieved.

So those are four suggested things that we might look at if indeed we are going to give States more latitude and ask them to try to produce with the dollars that we are sending.

Again, I think simply sending money, without any sense of what we are trying to do, will not work. If we shift responsibility but we do not demand results, I think we are going to be hypocritical and we are going to fail. This is not micromanagement, this is not trying to tell everybody how to do everything, but broad basic goals.

Let me say one other thing. I think people's frustration with our political system in government has been that we do not get the results. I think a lot of the frustration in the last two elections was, you know, people look at us as plumbers or doctors. Do not tell me how you are going to fix it; fix it. If I have a broken leg, or I have a broken pipe, I want it fixed. Do not bother me with how you are going to do it.

I would hope in this welfare reform, in addition to these kind of broad requirements we could say to State governments, if you do better from wherever you are starting at these kinds of standards, whatever they wind up being, we will give you more money. We are trying to get the result. We will pay for results. If you get more people employed, if you get more kids covered and not standing out on street corners and not being malnourished, we will give you more money.

And on this point, I know there is a desire to save money in welfare reform. Well, I am not so sure that needs to be our goal. Our goal is to get people off of welfare. Our goal is to get people in jobs. Our goal is to make sure kids are not malnourished. If that is our goal, let us not start off by saying we are going to save money, necessarily. We may not be able to do that.

I would be thrilled if we could use the money we have and get better results. And if we could spend a little more money and get the result, if we could really get people off of welfare, then we ought to try to do that if we really think the results are being achieved.

Now, let me go to tax proposals in the Contract. I think all of us believe that taxes are too high. All of us want to see how taxes can be reduced. I want to say that I am very happy that Republican leaders, including the chairman of the committee and others, the Speaker, the majority leader, have said that in this tax debate we are going to not have a bidding contest, as we have sometimes in the past, and we are going to try to do the cuts and bank them and pay for the tax cuts before we do them.

I totally agree with that sentiment. And for my part, and I think for the Democrats' part, we will try our best to live under that regime. We think that is the right way to do it.

I think that if that is what we do, there is going to be a limit to the tax cuts we can produce. I know a lot of the Republicans want to do every tax cut that is in the Contract. I would hope that we will again limit ourselves to what room we are able to find in the budget.

For my part, I think we should move the tax cut to the people who need it the most, and I will not bore you with the facts that you have heard me give before. You may not agree with my facts, but I believe in the last 20 years the middle class has stood still in income while their taxes, especially at the State and local levels, have gone up. I think people at the top have had their income go up dramatically while their taxes have gone down dramatically. And, therefore, I think if there is a limit to what we can do, we should focus it at the people who need it the most.

I think that what I hope we will talk about is how to best focus this at these middle-income people. I have an idea that I presented, which is one that I hope you will consider, that simply says we give a wage credit. We do not try to get too fine, we do not try to get too worried about who exactly gets this, but go at people who earn under $75,000 a year and give them a simple credit against their wages, period. Not on how many kids they have; not on how much tuition they pay. Everybody is treated the same way.

The President has a different and a very good proposal. He says do it on tuition. Do it to help for education. I think it is another very sound and good idea. Whatever the idea is, I simply hope that you consider focusing whatever moneys we are able to produce at the middle-income taxpayers.

Finally, let me talk about the balanced budget amendment, because I know this committee is going to be involved in that discussion. What I have been trying to say in the last days is that I hope whatever the balanced budget amendment turns out to be—and I don't know whether we will agree on one—but whatever it turns out to be, that along with it, the Congress passes a balanced budget resolution for 7 years, 8 years, whatever it is, and that that be presented before the amendment, whatever amendment it is is sent out to the States.

Why do I say that? I say that because I think people, as they are considering it in the States, should not buy a pig in a poke. This has real consequences in people's lives. It is easy to say let us balance the budget; it is hard to say how to do it. And you all know that.

The American people deserve honesty. We need to lay out for them what this means in their lives so they can determine whether or not they want to do it. I will not bore you with my version of a balanced budget. I have authored one. I have been for one. I am not for a supermajority to unbalance the budget. I will not bore you with why I think that should be.

I am for exempting Social Security because I think it is in a separate category and we do not want to break that contract. But whatever the amendment turns out to be, and the Congress will work its feelings about this, I would hope that we would pass the

Honest Budgeting Act or the Right to Know Act and put the specifics out there before the States take it up.

Let me end with this, Mr. Chairman. I think this is an important time in our history, as the Speaker said it was the other day. I think we have a chance to do some very important things. I would hope that we can work hard to find the common ground together.

I have been here now for 18 years. I know how hard it is to compromise. The reason we are here is that we are here sent by people who largely disagree over most issues and we are here to resolve conflicts. And as I said the other day, it is a marvelous achievement that we can do this peacefully and with respect and dignity.

If we are to find common ground, it only comes through hard work and compromise and reaching for an agreement that we can all live with. That is very hard to do. Not because we are trying not to agree, but because we do not agree. You can go down to any street in any district, houses that all look the same, walk door to door, and you will find serious disagreements not only between the people in the different houses but sometimes between the people in the same house. So to think that we do not have disagreements in the Congress representing 240 million people is just crazy. We do. The question is can we overcome the disagreement.

And I just pledge to you that we will work as long and as hard as we possibly can to find common ground, to move these issues in the proper direction, and to give answers and results to the American people. That is what they send us here to do and that is what we must do.

Thank you very much.

Chairman ARCHER. Mr. Gephardt, thank you very much for your input and for your very strong expressions of cooperation. With it we can move ahead to try to do the right thing for all the people of this country. I appreciate that.

[The prepared statement and attachment follow:]

NEWS FROM THE HOUSE DEMOCRATIC LEADER

For Immediate Release:
Tuesday, January 10, 1994

Democratic Leader Richard A. Gephardt
H-204, U.S. Capitol

Testimony House Democratic Leader Richard A. Gephardt
On the "Contract With America"
Committee On Ways and Means

Chairman Archer and members of the Committee:

I thank you for the opportunity to testify this morning, to share my views on the package of proposals that is now before the 104th Congress -- the "Contract With America."

But let me begin by saying how pleased I am that so much of this crucial debate will take place right here, in the Committee on Ways and Means. As a former member of this Committee, I have a great deal of respect for your tradition of partnership before partisanship.

Frankly, that's the only way this Committee can meet its broad mandate, which touches on virtually every area of our nation's government. So I look forward to working with Chairman Archer, and with each and every one of you, to make sure that all Americans have a stake in this Contract -- before we sign on the dotted line.

Before delving into the specifics of the Contract, I think it's useful to take a step back, and ask ourselves two broader questions: first, what do we really hope to achieve by passing this Contract? And second, for whom do we hope to achieve it?

It is clear by now that there was no massive mandate for this Contract. Most Americans hadn't even heard of it when they cast their votes this November. Many Americans still don't know what's in it.

That doesn't mean the Contract can't be a useful vehicle for reform and progress. It can. And with a great deal of discussion and revision, I hope that it will.

But let's not fool ourselves into thinking that this Contract is the be-all, end-all of the 104th Congress. Let's not fool ourselves into believing that the Contract With America -- whether you like it or hate it -- will really bring the kind of progress we need to build a better America for ourselves, and for our children.

You see, there's one question Republican pollsters failed to ask in the countless questionnaires and phone surveys that shaped this Contract:

Even if every clause in the Contract is signed into law, do America's hard-working, middle-class families really think it will make their lives any better? Or our schools any stronger? Or good homes any more affordable?

Congressional terms would be limited. But would the fifteen-year slide in America's wages and standard of living be limited?

Capital gains taxes would be slashed for wealthy investors. But would families who can't afford to play the stock market really gain?

A balanced budget would be required by Constitutional Amendment. But would an average family have an easier time balancing their checkbook?

The President would have the line-item veto. But would a struggling young couple be able to buy the items they need to support a family?

I daresay the answer to all these questions would be a resounding "no." And ultimately, this is my biggest concern with the Republican "Contract." At best, it is a marginal, peripheral diversion from the real task at hand: improving our standard of living, raising real incomes, and protecting America's jobs.

At worst, it's trickle-down economics all over again: huge tax breaks for the rich, massive defense increases, and only two ways to pay for it -- exploding the deficit, or carving huge chunks out of programs that benefit hard-working, middle-class families.

Ultimately, this is where the two parties diverge -- and this is where the great debates will take place in the new Congress. The Republican Party remains committed to a trickle-down approach that serves the best off, and hopes that somehow the rest of us can feed on the leftovers.

The Democratic Party thinks that government has to stand up for those who have been left out or locked out of good jobs, decent incomes, and real opportunities for the future.

While some of the issues the Contract raises are useful, even at its best it has little capacity to <u>help</u> the people it threatens to <u>hurt</u>.

When I look down the list of items -- a balanced budget, a welfare system that rewards work and responsibility, giving a break to overworked, underpaid, overtaxes families -- I find a lot of goals that I agree with.

But on just about every issue, the devil is in the details.

That may be why, in focus group after focus group -- and I know there were <u>many</u> -- people universally liked the Contract.

Reduced to sweeping statements of principle, the goals are unassailable. But when you read the fine print, it's a different story altogether.

Let's start with the critical issue of welfare reform. I believe very strongly in the value of work and personal responsibility. We've got to reform a system that simply doesn't do enough to emphasize those core values. I'm committed to doing that.

But the leading Republican proposals -- the Personal Responsibility Act, and the more recent effort to shift to Block Grants to the states -- amount to passing the buck, when we should be solving the problem.

The American people have a right to know that every dime they send to Washington to pay for public assistance programs is easing the transition from welfare to work. Under the Republican plan, all we're really doing is tossing the ball to the states, and hoping they do a better job.

We don't <u>require</u> them to do better; we don't even really <u>ask</u> them to do better. It's a cross-your-fingers, hope-for-the-best approach -- and an irresponsible way to spend taxpayers' dollars.

<u>I</u> say: as long as we're going to commit federal dollars to the states, let's focus on the notion of <u>rewards for results</u>. And let's demand that states meet some minimum standards -- not complex, bureaucratic standards, but basic <u>human</u> standards. I would suggest four:

First, let's draw a line in the sand when it comes to America's most precious and vulnerable resource -- our children. Let's say from day one that we will not design, or condone, or tolerate welfare reform that punishes children, <u>period</u>.

Let's tell the states that in return for a welfare block grant, they must ensure that children in the poorest families -- say, those under 90 percent of the poverty level -- all have decent nutrition, housing, and health care.

And this is a principle of protection that must extend far beyond the narrow confines of welfare reform. On crucial challenges such as crime, and health care, and education, and job training -- we must ask ourselves at every step of the way: are we doing enough for America's children? Are their needs being served? That is one of my highest commitments as a Democrat, and as an American.

Second, it never ceases to amaze me how, when we talk about welfare reform, when we talk about personal responsibility, usually that means the mother has to take responsibility. That's only half the equation. What about the father? Why are we going after welfare moms, but tolerating deadbeat dads?

What about a system of carrots and sticks to get fathers to play a role when a child is born out of wedlock? Let's ask the states to ensure that fathers be identified, and required either to join families through marriage, or pay child support. Fathers who can't support their children because they're unemployable should receive job training and job placement.

Third, it's time to move beyond the rhetoric of replacing welfare with work, and focus on the reality. We need a real commitment to creating jobs and opportunities, and to helping welfare recipients find them and qualify for them.

Under the Personal Responsibility Act, a paltry two percent of a state's welfare recipients are required to have jobs, and by 2003 that commitment rises to only 50 percent. Do we really think half a loaf is good enough? Can we really say to struggling families on welfare: we think half of you deserve a job?

We should ask states to ensure that a much greater proportion of those receiving A.F.D.C. are placed in jobs, and offered child care and health care for their children as well. I don't see why our goal shouldn't be 100 percent, not 50 percent. That's the only way "welfare to work" becomes a solution, not just a slogan.

Fourth and finally, we've got to stop pretending that the cold authority of a welfare check -- whether it comes from Washington or from the state house, whether it comes with carrots or with sticks attached -- will solve the problems of our neediest communities.

I've spent enough time in the needy neighborhoods of St. Louis to know that without positive role models, without a way to learn the skills of successful family life, we'll never build the kind of strong families that break the cycle of dependency. Let's ask states to develop programs that teach parents living in poverty to be better parents.

These may be mentoring programs, such as an outstanding program here in the District that both Speaker Gingrich and I have supported; programs for teenage parents in our schools; or existing programs such as "Parents as Teachers" or Head Start.

But the point is this: welfare reform that simply changes the logos on the checks until they run out will get us nowhere. Welfare reform that shifts responsibility, but doesn't demand results, will be doomed to failure. Welfare reform that gives lip service to strong families and work but doesn't lift a finger to provide them isn't just bad public policy -- it's plain old hypocrisy.

That's why I'm advocating the four standards I've outlined. It's not an effort to micro-manage: let the states meet these broad standards any way they please. But let's not just throw money at the states and abdicate the true federal role in this debate, which is leadership. Setting the goals. Laying out the vision.

We need a real partnership with the states. Partners don't just mail checks to one another; they work with one another. Dollars without direction and accountability is a recipe for disaster.

If the states show real progress toward meeting these standards for a substantial proportion of welfare recipients, I believe we should pledge them greater federal funding, to serve even more people the next year. Rewards for results. It's the only way to make sure the system really works.

I'd like to raise just two further points about welfare reform. First, I think it's a mistake to slash overall funding by 15 percent to reduce the deficit, as the Republican proposals do.

Ask any Governor: assuring decent jobs, feeding hungry children, helping people to live lives of decency and dignity, is neither cheap nor easy. Channeling all of the savings from welfare reform into deficit reduction, as the G.O.P. plan does, is like starving your children to speed up your mortgage payments. It just doesn't make any sense.

At the same time, let's not pretend that we have all the answers to this crushing complex of problems we call poverty and dependence. If we move to a system of Block Grants, let's give it five years to work. At the end of those five years, let's be prepared to reassess it, and start over if it doesn't work.

In the final analysis, it's a question of the kind of America we want to build. It's a question of the kind of people we want to be.

Speaker Gingrich has spoken very eloquently about his dream of America -- about the Monday morning we can all wake up and find that no child has been killed over the weekend; that our children have decent schools in which to learn and grow; that it is easy to find a job or create a job.

That's an admirable vision. But I have some caveats to that vision.

I dream of a Monday morning when our children are safe not because they have been ripped from their families and thrown into indifferent, big-government institutions -- but because we've made their families and neighborhoods strong.

And I dream of a Monday morning when it is not just easy to find or create a job, but when every American is ready to fill those jobs.

Now let's turn to the tax proposals in the Republican Contract.

Let me say as plainly as I can that I agree that taxes are too high, and it's time to cut them. I've fought for tax reform for years -- and you won't find a stronger advocate of a simpler, less burdensome tax system.

But let's talk brass tacks for a moment. Tax cut proposals may be a dime a dozen -- but they cost billions of dollars apiece. The 104th Congress isn't going to pass ten different tax cuts; we can probably afford to pass one.

So the question becomes: who needs that tax cut the most?

The Contract's answer is clear. Seventy-two percent of the benefits of the Capital Gains Tax Cut would go to Americans earning over 100,000 dollars a year. The family tax cut would go to families earning up to 250,000 dollars a year.

Over half of the benefits of the Contract's tax provisions for individuals would go to those earning over 100,000 dollars a year -- and a third would go to those earning over <u>200,000</u> dollars a year.

The flat tax proposal advanced by Leader Armey follows the same formula. According to the non-partisan Citizens for Tax Justice, if you earn 30,000 dollars, you'll pay 1,700 dollars <u>more</u> in taxes. If you earn 530,000 dollars, you'll pay 44,000 dollars <u>less</u> in taxes.

Even the <u>Wall Street Journal</u> predicted last month that the Contract's tax provisions would create, and I quote, a "new generation of tax shelters," allowing "some big and profitable companies to escape taxes altogether."

I'm not saying we should penalize the rich, or get into a big debate about who's middle-class and who's wealthy. But after years of tax giveaways to upper-income Americans -- after years of declining incomes for hard-working families -- I think it's clear what our priority should be.

We've tried trickle-down tax policies -- based on the notion that if you feed those who already have food on the table, some of the crumbs will fall to those who really need it. And according to any reputable or reasonable economist, that approach failed miserably. Isn't it time for trickle-<u>up</u> economics? Isn't it time for tax cuts and incentives based on the notion that if most Americans are struggling, we can hardly sustain our nation's businesses and corporations, let alone our own families?

That's why both the President and I have proposed a tax break for <u>working people</u>, anyone earning less than 75,000 dollars a year.

My approach is a straightforward tax cut, with no strings attached, whether or not you have children. I believe the best way to help working families is by letting them decide how to spend their own money. The less government interference, the better.

Astonishingly, the Republican approach denies all tax relief to those without children -- as if the childless haven't got a care in the world. Let's face it: the size of your family isn't always related to the size of your wallet. My tax cut proposal recognizes that reality.

Here are some of the details of my Working People's Tax Break:

25 percent of a family's wages and earned income would be exempt from taxes, up to a maximum of 5,000 dollars. In other words, if you earn 20,000 dollars, you won't have to pay taxes on the first 5,000. It's like having three months tax-free. The maximum family tax cut would be 750 dollars.

Individuals could exempt a quarter of their earned income up to 3,000 dollars, for a maximum tax cut of 450 dollars.

The plan would cost about 33 billion dollars per year for two years, and would give the average taxpayer a tax cut of 486 dollars. Overall, about 69 million Americans would benefit. Those receiving the Earned Income Tax Credit today would have to choose between the two.

I want to make it very clear that when I talk about giving a tax break to working families, instead of wealthy investors, I'm not advancing an anti-growth agenda. I'm proud of the President's programs and policies that have created more than five million jobs; cut the deficit for three years in a row; and brought unemployment down to an impressive 5.4 percent. I'll be the first to say that we have to do even better.

But the Democratic Party has a sacred commitment to help hard-working, middle-class Americans. Those are the people we've fought for -- and those are the people we're going to keep fighting for in the 104th Congress, with tax policies, and with <u>all</u>

policies.

For that reason, I must say that I'm deeply concerned that last week's drop in unemployment could lead to another damaging interest rate hike. The fact is, in recent weeks and months, some Federal Reserve officials have expressed the view that the economy is too strong.

I don't criticize the Fed lightly. But I wish some of the Fed officials who think the economy is too strong would come back to my district in St. Louis, and meet some of the families and workers who are barely making ends meet.

Our people are working longer hours, for less pay, with fewer benefits -- in jobs they're not even sure they can keep. If you ask them if the economy is too strong, I daresay they'd give you a very different answer than the average Fed official.

The Fed has already done a lot to tighten the economy. To take another drastic measure before fully gauging the results of these recent rate hikes could cause needless economic distress for millions of workers.

At the same time, the traditional view of inflation -- that strong growth leads immediately to higher prices -- simply doesn't hold true in a super-competitive global economy. If our manufacturers raised prices, they'd suffer serious setbacks in world markets. So while we must be careful, we need not be overzealous about this risk.

Unemployment may be down, but the fact remains that underemployment is rampant. Many of the jobs created in the past two years are not good jobs, and lack the kinds of benefits and security that ensure true, long-term economic strength and stability. Unemployment among young people and minorities is far higher than the national average.

If many of America's families are condemned to joblessness and hopelessness, what kind of recovery is it anyway? So I urge the Fed to move very carefully in this matter.

Let me raise one final issue today -- one which is not strictly within the jurisdiction of this committee, but raises questions that are of grave concern to this committee. I'm talking about the Balanced Budget Amendment -- and unfortunately, there's not much I can say about it, because it's a proposal wholly devoid of detail.

Let me be very clear about this: I believe in a balanced budget. But the question isn't whether you do it -- it's how you do it, and on whose backs. That's where this committee ought to be concerned.

Will Social Security or Medicare be on the chopping block? Will veterans' pensions be submarined? Will farm assistance be put out to pasture? Will major tax changes be required to balance the budget?

We simply don't know the answers. And it seems that some don't want us to know.

House Republican Leader Dick Armey says that if the people know what a Balanced Budget really means, they won't like it, Congress's "knees will buckle" -- and it'll be doomed to failure.

But we say: we're not signing this contract until you show us the fine print. We don't believe in cloak-and-dagger public policy.

The people have a right to ask: Is there some hidden agenda here? Is this a veiled attack on Social Security or Medicare? We need to know. And if the plan can't withstand the bright light of scrutiny, maybe they'd better go back to the drawing board.

That's why Senator Daschle and I have introduced the Honest Budget bill in both the House and the Senate. It's a bill that requires us to be honest with the American people -- to tell them exactly how they would balance the budget.

Under our proposal, before a Balanced Budget Amendment can be sent to the states for debate, Congress must present an actual balanced budget plan with reconciliation instructions -- a clear, line-by-line accounting of how they would achieve a balanced budget over the proposed seven-year period.

We won't delay a vote on the Amendment. But neither will we allow this Congress to balance the budget on the backs of working people and senior citizens. If we're serious about balancing the budget -- let's lay our cards on the table, and let the people be the judge.

I believe this same principle of open, honest debate should be applied to the way that this Congress calculates its budget estimates.

As you are all aware, some of our colleagues want to use something known as "dynamic scoring." It means that when we consider a proposal, if its authors believe it will create economic growth, they can subtract that growth from the cost of the proposal -- even if no respected economist or budget expert in the nation agrees.

Dynamic scoring isn't about objective fiscal analysis -- it's about blind ideology. It's about cooking the books when we don't like the real recipe. Supply-side economics has always been far outside the mainstream of economic opinion in this country. And its critics have been proven correct.

The American people demand that the numbers we use to measure a bill's impact on their lives be real, not rhetorical. Based on policy -- not politics.

That's the way this committee has always worked -- and I trust that tradition will continue. Quite frankly, there have been a lot of times when Democrats didn't like the numbers. But we never dared to corrupt the system to serve our own agenda. The truth isn't always easy. But it's always necessary.

And this isn't about partisan politics, as some have charged.

I think the new Republican majority will be surprised by Democrats' willingness to work with them, as partners, if we can have a frank and honest debate about the costs and consequences of the Contract.

That's where the Ways and Means Committee has a crucial role to play.

I served on this committee for 12 years -- and I'm very proud of the work I did with this committee, under presidents of both parties. This committee has always had an abiding commitment to the public interest -- to reasoned analysis, and serious scrutiny of each and every proposal.

Many party leaders have wished this committee would simply steamroller their agendas -- but the work that is performed here is too important, the stakes too high, for politicized public policy to reign supreme.

I urge you, in the days and weeks ahead, to hold fast to that commitment. To think not of the focus groups, but of the families where the husband works during the day, the wife works at night, and they barely ever see each other.

The families that have given up every minute of family time working two, three, even four jobs -- working in plants and factories where they're treated like robots, devoid of all meaning and fulfillment.

The families that want government reformed, and improved -- but don't want to see our safety net shredded, and our decency denied.

I think a lot of good can come of this Contract if it is redrafted with those families in mind. In its present form, its impact on their lives will be marginal at best, and devastating at worst.

Let's move through these first hundred days diligently and prudently -- and then let's get down to the real business of working America.

Thank you. Now I'm happy to take your questions.

# # #

Working People's Tax Break

- 25 percent of a family's wages and earned income would be tax-free up to a maximum exclusion of $5,000.
- In other words, an average working family making $20,000 would not have to pay taxes on the first $5,000 they earn.
- That works out to a family making $20,000 not having to pay federal income taxes for the first 3 months of the year under this proposal.
- The maximum credit for working families would be $750.
- 100 percent of the benefits of this tax proposal would go to taxpayers with adjusted gross income of less than $75,000.
- Individuals would be able to exempt 25 percent of wages and earned income up to a maximum of $3,000, for a maximum credit of $450.
- The cost of this plan would be roughly $33 billion per year. The tax break would be available for two years.
- An average taxpayer would get a tax cut of $486.
- 69 million taxpayers would benefit.
- Individuals eligible for the Earned Income Tax Credit could elect to continue to get either the EITC or the Working People's Tax Break. They could not receive both.

Preliminary Distributional Analysis

Income Class (AGI)	Distribution of Benefit	Average Tax Cut
Less than $10,000	1.6%	$149
10-20,000	12.3%	325
20-30,000	20.4%	475
30-40,000	23.6%	590
40-50,000	18.7%	634
50-75,000	23.3%	523
75-100,000	0.0%	0
100-200,000	0.0%	0
200,000 and over	0.0%	0

Chairman ARCHER. Let me say to the members that I would hope we do not get into the balanced budget amendment because that is not within the jurisdiction of this committee. I am pleased to receive your views on it, but I was part of the debate in the Judiciary Committee yesterday, and I think we are going to have to leave the details to them to work out. We have plenty on our plate here that we can discuss with you.

Second, I am pleased that you support the concept of putting in place spending cuts and that we will then know how much revenue we can lose, in effect, in this committee without exacerbating the deficits. I can assure you that this committee will not exceed whatever the limits are of spending cuts when we pass any tax cuts. That is the procedure, I understand, that we will follow, and I support it very strongly.

It is my intention, because we have a limited period of time for questioning, to begin to recognize members at the cutoff point when Speaker Gingrich is here so that each member will have an opportunity to question. Without objection, I would ask the committee to accommodate me in that regard in fairness to the members.

In addition, I would ask the members to attempt to limit their questioning time to 2 minutes so that more members will have an opportunity to have a colloquy with you. Prior to starting that procedure, however, I will recognize the minority leader of the committee for inquiry.

Mr. GIBBONS. I am not going to take my time. I would rather yield my time to some other member junior to me, Mr. Chairman.

Chairman ARCHER. I thank the gentleman.

I will also recognize the ranking Republican who was here at the time the gavel went down for inquiry, and then I will proceed down the list beginning where we left off with Speaker Gingrich.

The gentleman from California, Mr. Thomas, is recognized.

Mr. THOMAS. Thank you, Mr. Chairman. Being a junior member to the gentleman from Florida, do I get his 2 minutes?

Chairman ARCHER. I don't think so.

Mr. THOMAS. OK. Then mindful of the 2 minutes, I am going to ask you some questions and I would appreciate succinct answers so we can move forward. But, first of all, welcome back to the committee. It is good to see you.

You talked at the opening of your statement about children, and all of us are concerned about children. You made the comment about Speaker Gingrich's statements about children in his opening speech. The President, in his presentation of his tax plan the other night on television, talked about children as well. My understanding is the President's tax break is denied to parents of teenage children over 13 years of age. Do you agree with that aspect of the President's program?

Mr. GEPHARDT. As I said in my testimony, I guess I would prefer in the tax area we not get too fine and get into all those kinds of questions. I support what the President has presented in concept. I would urge the committee to look over the details and to filling out exactly how you want to do it.

I guess I am most comfortable, although I could live with what the President has or something like it, with a tax cut that does not decide it on the basis of children or nonchildren and simply be a wage credit.

Mr. THOMAS. On page 2 of your testimony, Dick, you say at the bottom, "Let's tell the States that in return for a welfare block grant, they must ensure that children in the poorest families, say those under 90 percent of the poverty level, all have decent nutrition, housing, and health care." In your mind, is that an unfunded mandate?

Mr. GEPHARDT. No, I think it is a goal or a standard that you are reaching for. I think we should shoot high, and I think all of us want children to not be out in the cold and not be starving to death, and so I think we ought to set a very high goal and then—look, the Governors have come here and said, in a bipartisan way, they can do this. They can do well. They want to be freed up so they can see what they can achieve. I am not unwilling to think about doing that, but I do not want to just turn the money over with no admonition of what we hope can happen.

Mr. THOMAS. But you do not see it as an unfunded mandate?

Mr. GEPHARDT. I do not. I think if you set a standard—this is not micromanagement.

Mr. THOMAS. Last question. On page 7, where you say you "will not delay a vote on the amendment"—that was the balanced budget amendment—"but neither will we allow this Congress to balance the budget on the backs of working people."

Just let me say that those kinds of phrases—because, frankly, there are not enough people in this society who clip coupons or who do not work. Folks may want to define work one way or another, but when you use the phrase to balance the budget on the backs of working people, that really is the kind of statement that does not move us forward in trying to solve the common problem I think that both of us are looking for.

There are an awful lot of people in this society who work for differing amounts of wages and what we have to do is solve a real problem. And saying that you will not allow the Congress to balance the budget on the backs of working people really does not advance the debate very far. But I thank the gentleman for his testimony.

Mr. GEPHARDT. I thank you.

Chairman ARCHER. The gentleman's time has expired and the Chair recognizes the gentlelady from Connecticut, Mrs. Kennelly, to inquire.

Mrs. KENNELLY. Thank you, Mr. Chairman; and thank you, Mr. Gephardt.

We talk about children—and I would like this to be highlighted once again—we talk about children, all of us, because when we are talking about welfare, 10 million of the 15 million concerned are children.

I want to go further with something you mentioned at the beginning, Mr. Gephardt, and something that is important to many of us and that is child support enforcement. The Contract has child support enforcement included in the block grant back to the State, and yet we know over the past years, as we have wrestled with this very difficult question, any real progress that has been made has been through the Federal level, through the IRS, or through really increasing grants and increasing paternity establishment.

Could you expand further how you would address child support enforcement? Does it go back to the block grant and compete with jobs programs, or are we to try to keep it on track with the Contract going quickly, because we know we try to get teenage mothers to be responsible. We should make fathers be responsible also. How would you handle child support enforcement at this time on this schedule?

Mr. GEPHARDT. Well, what I was suggesting is that one of the four standards or requirements, general requirements, that I would want to set is that we identify parents, that we have an active child support enforcement program in the States. And if we need, as we have thought we have needed in the past, a Federal partnership with that to make it work effectively, so people do not move around and escape their responsibility, we should do that.

All I am saying is to have welfare reform without an important element of identifying fathers and getting fathers to live up to their responsibilities, I think, is a terrible mistake. We would send a terrible message if we go through this and do not make that a big part of what we are doing.

Mrs. KENNELLY. Thank you, Mr. Gephardt.

Chairman ARCHER. Mr. Hancock will inquire.

Mr. HANCOCK. Thank you, and welcome, Dick.

Last Wednesday, at the opening of this Congress, you made the comment, let the great debate begin. And I think that is exactly where we are now. We do need to let the great debate begin and see if, in fact, we can make some major reforms in the direction that this country is heading, has been heading for quite some years.

You mentioned, and I just want a real brief statement here, in your opening statement that you are not impressed very much with dynamic scoring when it comes to economic activity. Our whole system is based on dynamic scoring. If it was not for dynamic scoring, there would not be any risk takers, nobody would do anything, because if they operated on a static model everybody would say, well, it is hopeless; you cannot change anything. Every businessman operates on dynamic scoring. He invests his money for the future. Every person going to school operates on dynamic scoring. Even when you get married you operate on dynamic scoring because you are looking for future benefits.

So I would like to point out, Mr. Gephardt, that dynamic scoring is what has made this country great for almost 200 years, and I wish you would really take a real good look at that aspect of everything that we do should be judged on the basis of how that is going to impact in the future instead of in the immediate, just based on the exact past history. Anyway, thank you very much.

Mr. GEPHARDT. I thank the gentleman for his suggestion.

This is an area where, I would hope, we could have a bipartisan, serious, open, honest discussion. It is one of those areas where we are not flying completely blind. We have past projections and past results, and I talked to Majority Leader Armey some about this, and I would hope that we could maybe engage in a real inquiry together on history to see what has worked and what has not. Because we are talking about something very important here, and that is what happens to the Federal budget, the deficit.

We do not want to go off with a bad projection that winds us up further in the hole, which is sometimes what we have done in the past. But it is one of the areas where it is not all theory and ideology. It really gets down to some hard facts and we should be able to look at those and make some judgments.

Chairman ARCHER. Mr. Ramstad will inquire.

Mr. RAMSTAD. Thank you, Mr. Chairman, Mr. Gephardt.

As I understand—you can tell I am a new member of the committee, I don't know how to turn on the microphone—Mr. Gephardt, as I understand your tax cut proposal, it is a credit for all taxpayers with an adjusted gross income of less than $75,000; is that correct?

Mr. GEPHARDT. That is correct.

Mr. RAMSTAD. Wouldn't your proposal, if it applies to single individuals, really exacerbate the already onerous marrying penalty?

Mr. GEPHARDT. I am more than willing to look at solutions to the marrying penalty problem. We have done that in the past, and you could do that in this proposal as well. I was trying to deal with a concept, what this tax cut might look like, who would get the major benefit from it. But I am not against trying to figure out how to undo the marrying penalty.

Mr. RAMSTAD. I appreciate that recognition of that penalty. I was struck by the contrast to the provision in the Contract, expressly proposing to reduce that penalty, and I appreciate your willingness to work with us toward that end.

The second area I would like to examine, in the 2 minutes allotted, concerns another real problem facing our economy. I am alarmed when I read and hear about the low net national savings rate. One economist at Harvard concluded recently that even if all the net savings went into machinery and equipment, the level of such investment in this country would still be too low to sustain long-term economic growth.

My question is, what tax policy do you believe would best encourage Americans to put more of their income into long-term savings to address this problem? As I am sure you know, Mr. Gephardt, we rank number seven in the G–7 nations in terms of our savings rate.

Mr. GEPHARDT. Representative, I have, through the years, been increasingly unimpressed with our ability to induce the actions we want in a lot of areas by what we do with the Tax Code. I do not agree with Dick Armey's flat tax, because I think it is very unfair, and we will have more on that later. But the general concept of what he is doing is something I am interested in, and a number of Democrats will be working on an alternative, so-called flatter tax proposal, and that is the way I think we ought to move.

I do not think we can micromanage the society in the Tax Code. I think we have overcomplicated it. I think we wind up confusing ourselves and our constituents, and I think if we could get most Americans on a 10, 10½, 11 percent rate, without any complications, then people would save and invest according to what makes sense, and that is what they should do.

Chairman ARCHER. Gentleman's time has expired. Mr. Coyne will inquire.

Mr. COYNE. Thank you, Mr. Chairman, and welcome, Mr. Leader, and thank you for your statement.

My question is, is it realistic to think that we can do meaningful health care reform without first doing welfare reform? I raise the question to see what your thoughts are on whether or not single parents would be able to get off of welfare without health insurance with two or three children.

Along with that, what should our priority as a party be regarding health care reform in this session of Congress?

Mr. GEPHARDT. Well, first, I believe and I think most people believe, if you could get everybody included in a health care policy, and that is a big statement, a lot of people would leave welfare. We induce people to be on welfare to get Medicaid. That is exactly what we are doing today. And if we could solve the health care problem, which is easier said than done, as we all know, we would make probably the most important step toward welfare reform in getting people off welfare.

I do think that as we do welfare reform, we ought to, as a Congress, address health care reform. And, again, I offer my hand to the other side to figure out what we can do. And I am now of the opinion that we could not do a big reform, so let us do smaller sensible reforms. And I am willing to start small. I would say tiny steps for tiny tots, and I think we should do something that we can agree on and then let us make it work. Let's show the American people that we know we have some sense of what we are doing; that what we did made intelligent sense and then demonstrate to them, again results, that it works. And then we can take the next step.

Maybe the first step is insurance reform. And maybe a few other minor things with it. Let's do that and figure that out together and let's walk before we run. And I am fully prepared to do that and it would be a very important step, along with welfare reform.

Mr. COYNE. Thank you.

Chairman ARCHER. Mr. Zimmer will inquire.

Mr. ZIMMER. Mr. Gephardt, in recent weeks you have spoken eloquently and movingly about the plight of many middle-class families whose income has stagnated over the last 20 years and we Republicans share that concern. I appreciate your expressed willingness here to work on a bipartisan approach to this problem.

Would you agree that a major element behind that stagnation in living standards for many Americans is the fact that our rate of investment and savings has been extraordinarily low, as Mr. Ramstad has referred to?

Mr. GEPHARDT. I think it is part of the answer. I think there are building blocks we can all agree on: Economic success, infrastructure, education, research, and certainly savings and investment, along with labor management relations and motivated workers together make a high standard of living and high productivity.

I just guess I have come to the conclusion, and I may be wrong and others may be right, that we can easily use the Tax Code to induce the result that we want on savings. I do not think it works very well. I think it winds up substituting the way money is saved rather than actually increasing the savings pool. And I just think if we could work to lower tax rates as low as we can get them for all Americans, that we would get more savings and the right kind of savings that we should have, and that is what I would like to work to do.

But I understand the opposite point of view. People love IRAs, capital gains and other methods of making this happen. I just am not impressed with the results.

Mr. ZIMMER. Let me put a hypothetical question to you, then. If there was a tax rate cut which would substantially increase savings and investment in this country, which would create more good paying jobs for middle America, and if that tax rate cut would not reduce Federal revenues, would you support it, even though the direct beneficiaries initially would be disproportionately people who earn higher incomes?

Mr. GEPHARDT. I guess the problem is the if.

Mr. ZIMMER. Well, it is a hypothetical question. We can argue about the details later. Now we do not have time.

Mr. GEPHARDT. I cannot say I agree with the if. Obviously, you can assert that and you may be right and I may be wrong. I cannot agree with the assertion. I think the best way to go about this is to simply get income tax rates down as low as we can get them for everybody, and I think that alone will allow people to spend more time and more effort either earning money or investing money than they are doing today.

I think we have been so cued, not in a negative sense, we are all trying to do the right thing, but we have been so fine and so sophisticated in what we are trying to get people to do that we have frustrated our intent.

You know, we set up a tax break and then people all run to that, and then we worry somebody is going to abuse it and then we refine it and write more regulations and make it more complicated. People are driven crazy by this Tax Code. It is a disaster. It just does not work anymore. We are not smart enough. We are winding up trying to write a boutique Tax Code for everybody in the country. It does not work. We have to make it simple. Throw it all out and just say, this is what you pay.

Now, I want it to be progressive, as it is today. I do not want to go backward on that. But you could get four out of five Americans at a 10 percent rate and that, to me, would be real progress.

Mr. ZIMMER. Well, I would just point out your proposal would make the Tax Code even less simple than the one you are criticizing. I look forward to working with you on this issue. Thank you.

Mr. GEPHARDT. Thank you.

Chairman ARCHER. The gentleman's time has expired.

I want to thank the minority leader for his embracing that we need to perhaps replace the income tax with a better form of taxation.

At this point, Mr. Levin will inquire.

Mr. LEVIN. Thank you, Mr. Chairman. I am tempted to ask more on the tax proposal because, Mr. Zimmer, I think your question really is not hypothetical in the sense we tried that in the early eighties, and I think there is some history we at least need to look at.

Let me ask you, Mr. Leader, and welcome, a question about welfare reform. You have urged results-oriented welfare reform. I speak as someone who has been, over the recent years, in favor of much more State flexibility, but let me ask you a question about the potential tension between some of the block grant proposals and the results-oriented approach.

Some of the block grant proposals say give the State the same amount of money for 5 years in a block grant and let them do as they see fit. You are suggesting a results-oriented approach.

What happens if there is a recession during those 5 years? In the States, having a set level for AFDC or for food stamps, unlike the present, where the Federal portion goes up, how do you put those two things together?

Mr. GEPHARDT. Well, I think we can think about a capped entitlement for States as opposed for individuals, and we could make it sensitive. You could write it so that it was sensitive to a number of outside factors if you wanted to do that, such as recession and so on. That would be possible to write.

But I also think that whatever amount of money we put into that capped entitlement, the theory of what we are doing is that States, if given more flexibility, can get more coverage, more results, more good things out of the money they get. And, in effect, that is why I like reward for results. I would like to put a little bit of reward on top of it, so that if they are really showing more progress from wherever they start toward those results, you even help them some more.

So you induce almost a national competition to see who can do this the best; who can get the result. But you have to have something to judge people against in terms of a result or you are just cutting a check and hoping for the best, crossing your fingers. And I do not think that works. But I think you can write a formula for a capped entitlement for States that is somewhat sensitive to exogenous factors.

Mr. LEVIN. Thank you.

Chairman ARCHER. Mr. Johnson will inquire.

Mr. JOHNSON OF TEXAS. Thank you, Mr. Chairman, and good morning.

Chairman ARCHER. If the gentleman will suspend. We are going to reach the hour here in about 3 or 4 minutes and I intend to recognize Mr. Collins and then we will release Mr. Gephardt and Secretary of HHS, Donna Shalala, will then appear as a witness.

Mr. JOHNSON OF TEXAS. Thank you. Thank you, Mr. Chairman.

Mr. Gephardt, you talk about us not identifying the family and the children as a problem, and yet you are the one that says we do not need to give a deduction for children; that it should be for the individual. Can you explain the dichotomy of those viewpoints?

Mr. GEPHARDT. I guess it goes back to my basic philosophy about taxation. I really believe we have confounded ourselves in the last 40 years by trying to write a Tax Code that is adjusted for everybody's personal situation. I think it is too hard, I think it is too complicated, and I think it is self-defeating. I think the American people are fed up with a tax system that drives them crazy.

I think we should let people make their own decisions about how they spend their money. We ought to get tax rates as low as we can get them and we should turn people loose to do what they want. If they have 10 children, then they have to deal with 10 children. If they want to invest, they have to figure out what to invest in that will make them the most money. But we cannot micromanage it and figure it out for everybody from here. I think we have to leave those decisions about their money to them, take as little of it as we can to run this government, and we will have a raging debate over what the government should and should not do, and then turn them loose with their creative powers to do what they want to do. And I want it to be progressive. We may have a fight about that.

Mr. JOHNSON OF TEXAS. I think that is exactly what Mr. Archer has in mind, but we need to put money back into the people's pockets right now, and I think those credits do that for the people who have kids. You keep talking about being aware of the children and a welfare program and we are talking about tax reductions which would put money in people's pockets today.

Mr. GEPHARDT. I understand. I understand. And I am not unwilling to be for something for kids and tuition and so on. But you get into all kinds of complications. What about a couple that has kids that have just gotten out of college and they are still sitting there with loans they have to pay off? Are they included?

The world and families are complicated. Everybody is in a different situation. And you start trying to write something that takes care of everybody's deal and reality is tough.

Mr. JOHNSON OF TEXAS. I will draw one more conclusion. You made a point earlier, as Ross Perot says, just stop the car and fix it. Well, that is what we are trying to do, is fix it, right now. Then we go on from there with Mr. Archer's idea of possibly no income tax at all.

Thank you for your comments, sir. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Collins will inquire.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. Gephardt, I find it of interest that you mention you would be willing to go with a lower tax rate that would apply to all, because, to me, all would mean those with the higher incomes who would then reap a greater benefit from a lower tax rate than the families that you have put an emphasis on.

But my question to you deals with an area of the tax laws that I think is one of the biggest disincentives for capital investment and also has resulted, I think, in the loss of many jobs around this country, especially in the area of manufacturing and assembly lines, and that is the alternative minimum tax. And I would like to have your views on the alternative minimum tax as to how to change it, repeal it, or what you think we should do with it.

Mr. GEPHARDT. Again, if you went to what I am talking about, or Dick Armey's talking about, although I do not agree with his total approach, you would not need an alternative minimum tax because everybody would pay tax. You would not have deductions and exemptions and all the other things we use to get our tax rate down.

I think it is wrong for anybody in the country to get themselves in a position, even though they are doing all these wonderful things that we have said in the Tax Code we want them to do to pay no tax, it is hard for somebody to swallow out there working for $30,000 or $40,000 a year somebody making $2 million a year pays no taxes. They may be doing a lot of wonderful things we ask them to do in the Tax Code but it grates on people that that is the case.

So again, if we could simplify the code, get out of the business of micromanagement, trying to figure out for everybody what they should do, we would not have to worry about a minimum tax. Everybody would pay a minimum tax at the lowest possible rates.

Mr. COLLINS. I take it then that you would be very interested in doing away with or repealing the alternative minimum tax?

Mr. GEPHARDT. I am for changing this Tax Code, and I will be offering ideas; and then, as was said, let the debate begin.

Mr. COLLINS. Good. Thank you, Mr. Gephardt.

Mr. GEPHARDT. Thanks.

Chairman ARCHER. Dick, thank you very much for your excellent testimony.

Mr. GEPHARDT. Thank you, Mr. Chairman. I always enjoy being in this great committee. You all serve on—and I hope you won't repeat this—but the best committee in the House, maybe in the Congress, probably, certainly in the Congress.

Chairman ARCHER. I think there are people here who will repeat it, but of course we won't argue with it, as members of this committee. Thank you very much.

Mr. GIBBONS. Of course, we remember your distinguished service here for so many years, too, Mr. Gephardt.

Mr. GEPHARDT. I enjoyed every moment of it. It was the best time I spent in the Congress, believe me.

Chairman ARCHER. The committee will stand in recess momentarily for the arrival of the Secretary of HHS, Donna Shalala.

[Recess.]

Chairman ARCHER. If our guests will please take their seats so we can proceed. We have a lot of witnesses today to hear from.

The Chair now welcomes our next witness, the Honorable Secretary of Health and Human Services, Donna Shalala. We welcome you to our committee, the committee that Minority Leader Gephardt just said is the most important, influential and powerful committee in the Congress, and we are pleased to hear your testimony. Immediately prior to that I will recognize Sam Gibbons for any comments that he would like to make.

Mr. GIBBONS. The only thing Mr. Gephardt could have said that he didn't say, was that it was filled with the most charming guys and gals that we have around here. And perhaps I think it better, though, that I yield my time to the next ranking Democrat who hasn't had a chance to inquire.

Chairman ARCHER. Madam Secretary, we welcome your testimony.

STATEMENT OF HON. DONNA E. SHALALA, SECRETARY, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Secretary SHALALA. Thank you very much, Mr. Chairman.

I should add my comments to Mr. Gephardt's about my admiration for this committee and for the work that you have before you.

I would like to thank the members of the committee for the invitation to appear before you today. I am pleased to be with you to talk about the Contract With America and to begin with what I believe is an important dialog with each other and with the American people.

I also have been asked to announce that the President will host a bipartisan working session on welfare which will include State, Federal and local elected officials on January 28, and the White House will extend the invitations today.

I would like to begin today by talking about our vision for welfare reform and the President's view of the Personal Responsibility Act found in the Contract With America. I have submitted more detailed testimony for the record.

I think it is fair to say, after consulting with Members of Congress, with people on welfare, with business leaders, with welfare experts, with religious leaders, with Governors, with State legislatures and county officials all across this country, the President honored his promise to the American people by submitting the Work and Responsibility Act to Congress last year. This was a bold, historic piece of legislation which would fundamentally change our approach to helping young parents move from dependence to independence, and it grew out of the President's longstanding commitment to welfare reform.

As Governor of Arkansas he worked closely with national and State officials from both parties to pass the Family Support Act of 1988. That act served as the impetus for States to begin changing the welfare system to one that encourages work, not dependency.

In the last 2 years we have worked with Governors and other elected officials to grant 24 waivers that give 23 States the flexibility to design welfare reform strategies that meet their specific needs. We have approved more welfare waivers than all the previous administrations combined.

The President's bold approach to welfare reform is based on a simple compact—job training, child care and child support enforcement will be provided to help people who are willing to work, make the move to independence. Time limits will ensure that welfare is seen as a hand up, not a handout.

Our approach emphasizes three American values: Work, responsibility, and reaching the next generation. But today welfare does not emphasize work, responsibility, and reaching the next generation. We agree on this, and both Republicans and Democrats have sought to change this with welfare reform. Yet from our perspective some elements of the Contract With America seem inconsistent with these values.

Let's talk about the value of work first. We are committed, first and foremost, to ensuring that everybody who can work does work and that current welfare recipients become taxpayers. That is what this great national debate on welfare reform must be about.

More something for nothing is not the answer. We believe that work is the answer. Our innovative approach to welfare reform puts work first, and in doing so it differs from the Contract's proposal in some important ways.

First, we send a critical message to people from the very first day they apply for welfare. You must work, we expect you to work, and we will help you prepare for work so you can stay off welfare for good.

We require those who are employable to move into work as quickly as possible by engaging in an up-front job search in education and in training, and we expect States to hold up their end of the bargain. And for those who refuse to train for work, for those who refuse to look for work or accept work once it is offered, the consequences are clear—cash assistance will first be reduced and then eliminated.

We also believe that people who can work should be treated differently from those who can't. Here I draw a sharp distinction between our approach and the Contract With America. We propose that everybody who can work does work. People who reach their time limits but can't find jobs must work for their benefits in temporary, subsidized jobs.

In contrast, the Contract ends all adult assistance after 2 to 5 years. Even if the recipients are willing to work but can't find work, even if the recipients are caring full-time for disabled children and even if the recipients are disabled themselves, the Contract ends all of their assistance.

Moreover, this is a lifetime limit. Once adults reach their limits, even if they have gone to work for many years and then lose their jobs due to a serious accident or an illness or recession, they cannot get aid.

We are pleased that the Contract's welfare provisions have been revised since when it was introduced last week to eliminate the mandate that aid to children must be cut off after their adult care givers reach their 5-year lifetime limits.

The second key value in our approach is responsibility. We believe that because every child has two parents both of them should be required to provide support. That is why, as an integral part of welfare reform, we have proposed a tougher, more uniform child support enforcement system as well as a stronger requirement for paternity establishment.

We also would impose tough new penalties for those who refuse to pay, including stronger wage withholding efforts, suspension of drivers and professional licenses and even property seizure. In stark contrast, the Contract includes few child support enforcement provisions and could actually reduce funds for child support enforcement.

In addition, our approach would deny AFDC benefits to the mother only after the State has determined that she will not identify the father. Once the mother has identified the father, then the responsibility properly rests with the State, which is given 1 year to establish paternity or face penalties itself under our proposal.

The Contract, on the other hand, denies benefits to any child for whom paternity has not been established. Even when the mother has identified the father and the State has not made a serious effort to locate him, the innocent child is held accountable. This is unfair. I think we can work together to address this issue.

We also demand responsibility and accountability from government by requiring States and the Federal Government to work together to implement new state-of-the-art measures to detect and prevent many types of fraud and abuse. These new systems will also help locate absent parents who are not paying child support. The Contract With America does not create any of these systems.

Our final bedrock value is reaching the next generation. We would put into place preventative measures to break the cycle of dependency. Welfare dependency could be reduced significantly if young people delayed sexual activity and childbearing until both parents were ready and able to assume the responsibility of marriage and supporting and raising children.

Our approach is aimed toward preventing teen pregnancy, and it requires that a minor parent live at home, identify the child's father and stay in school to get benefits.

Our plan of time limits and work requirements sends a strong message to young people that welfare will never be the same, that it will be a second chance, not a way of life. But we strongly disagree with the Contract's approach of denying benefits to children born to mothers under 18. Whether or not their parents are able to work, whether or not their parents are properly caring for their young children, the Contract With America raises the possibility of sending them to orphanages.

Of course, we are not suggesting that all of these children will wind up in orphanages. In fact, some parents will move on to lives in the mainstream. But States will have to find a way to care for the others.

We believe that the solution to welfare is not to make children go into foster care or into orphanages, it is to make their parents go to work. Yes, we have to take bold steps to tackle the problem of teenage pregnancy, but we can't give up on teenage parents.

To be eligible for support, we must insist that they stay in school. We must insist that they live at home. We must insist that they prepare for work. We all must be part of a national effort against teen pregnancy to make it clear that young people should not become parents if they were not prepared to take on the responsibilities for their children's futures. This is a critical element of welfare reform.

As we join forces to move people from welfare to work, we also have to address the bureaucratic absurdity and the human tragedy of welfare lock for people who want to work but go on welfare or stay on welfare because they have no health insurance and need the Medicaid program. The way to address this tragedy is to reform our health care system so that working families have access to affordable private health insurance.

Mr. Chairman, while the Contract With America does not address health care reform, the statement I have submitted for the record outlines our views on the specific health care provisions included in the Contract. Let me say that the administration remains firmly committed to providing insurance coverage for every American and to containing health costs for families, for businesses and the Federal, State and local governments. As you know, the President has written to the new leadership in Congress to express his strong desire to work in a bipartisan way to take steps toward achieving these goals.

We can pass legislation that addresses the unfairness in the insurance market. We can make coverage more affordable for working families and children. We can assure that the population served by Medicare and Medicaid are protected. We can reduce the long-term Federal deficit. And we can strengthen tools available to combat health care fraud, waste and abuse.

Mr. Chairman, we in the administration look forward to working closely with you and your colleagues in the new Congress on these critical health care and welfare issues.

I believe that we have a rare opportunity to move this country forward. I believe we can pass bold initiatives in welfare and health care. I believe we can pass the President's Middle-Class Bill of Rights. We can help all Americans to renew their faith in government.

We are ready to sit down and work with this committee, with this Congress, with elected officials across the country and, of course, with the American people to get the job done.

Thank you very much.

[The prepared statement follows:]

Testimony
Donna E. Shalala
U.S. Secretary of Health and Human Services

Introduction

Thank you Mr. Chairman and members of the Committee for the invitation to appear before you today.

I'm pleased to be with you to talk about the Contract with America and to begin what I believe is an important dialogue with each other and the American people.

In the last two major elections -- the presidential election of 1992 and the congressional elections of 1994 -- the American people sent Washington a crystal clear message: They want change.

They want us to stop the gridlock, stop the infighting, and make sure that everything we do makes a positive difference in people's lives.

That is why we are here today.

To write a new chapter in bipartisan government.

One that begins with a conclusion -- And that is to make sure that at the end of the day we have taken action to improve the lives and prospects of every American.

I am here to pledge the commitment of the Clinton Administration to this approach.

We have already picked up the mantle of change and for the past two years we have been about the business of carrying out the will of the people.

We passed the largest deficit reduction plan in history -- nearly $500 billion dollars over five years.

We created over 5 million jobs.

We worked with many of you on this committee to pass NAFTA and GATT -- historic legislation that will open up foreign markets for our products and open up lucrative job opportunities for millions of Americans.

We expanded the Earned Income Tax Credit -- which reduces taxes for 15 million working families and creates a powerful incentive to work and stay off welfare.

And as a next step, we have proposed the Middle Class Bill of Rights to reduce taxes for hard-pressed working families who are struggling to save money, send their children to college, and prepare for a better economic future.

We did one more thing that should not be overlooked or forgotten. We worked long and hard to put the American people first by addressing two of the great domestic policy challenges of the century -- health care reform and welfare reform.

I want to begin today by talking about our vision for welfare reform and our view of the Personal Responsibility Act found in the Contract with America.

Welfare Reform

After consulting with members of Congress, people on welfare, business leaders, welfare experts, and governors all across the country, President Clinton honored his promise to the American people by submitting the Work and Responsibility Act to the Congress last year.

This legislation would fundamentally change this country's approach to helping young parents move from dependence to independence, and it grew out of the President's long-standing commitment to welfare reform.

As governor of Arkansas, he worked closely with national and state officials from both parties to pass the Family Support Act of 1988.

That legislation served as the impetus for states to begin a major effort at changing the welfare system to one that encourages work, not dependency.

When he ran for President, he called for "an end to welfare as we know it."

In the last two years, we have worked with governors and elected officials to give 24 states the flexibility to design welfare reform strategies that meet their specific needs.

This is more waivers than all other previous Administrations combined.

Rooted in the bedrock American values of work and responsibility, the central focus of our approach to welfare reform is a few simple goals:

The first is to move parents off welfare and into jobs as quickly as possible so that they can support themselves and their families.

The second is to require absent parents to meet their responsibilities and pay child support.

And the third is to reduce teen pregnancy.

Mr. Chairman, I believe we all share these goals.

The President's approach to welfare reform emphasizes three important values: Work, responsibility, and reaching the next generation.

I think these are widely-shared values -- American values -- values that built this country in the past and are critical to our future.

Today, welfare has the values wrong: We know this, we agree on this, and both Republicans and Democrats have sought to change this with welfare reform.

Yet, from our perspective, there are elements of the Contract with America that seem inconsistent with these values.

Let's talk about work first.

We strongly believe that welfare as we know it will not have ended until we fundamentally change the system: Welfare must be about earning a paycheck, not collecting a welfare check.

As the President has said, "Work is still the best social program ever invented, and it gives hope and structure and meaning to people's lives."

To reinforce and reward work, our approach is based on a simple compact. Job training, child care, and child support enforcement will be provided to help people who are willing to work to make the move to independence.

But time limits will ensure that welfare is seen as a hand up, not a handout.

We are committed first and foremost to ensuring that everybody who can work does work. The American people want a government that honors their values and rewards people who play by the rules.

If we want to help welfare recipients become taxpayers, we must challenge individuals to take responsibility for their own lives -- and help them get ahead when they do.

For years, Republicans and Democrats alike have agreed that the central goal of welfare reform must be work. That's still the case: People who can work ought to go to work and earn a paycheck, not a welfare check.

That is what this great national debate on welfare reform must be about. More "something for nothing" is not the answer. More orphanages are not the answer. Work is the answer.

Our approach to welfare reform puts work first, and in so doing, it differs from the Personal Responsibility Act in some important ways.

First, our plan sends a critical message to people from the very first day they go on welfare: You must work; we expect you to work; and we will help you prepare for work so you can stay off welfare for good.

To prepare people to work and support their families, we would require those who are employable and who would benefit from having more skills to move into work as quickly as possible by engaging in upfront job search, education, and training -- and we would expect states to hold up their end of the bargain.

Indeed, we believe that people on welfare ought to sign a personal responsibility agreement and develop an employability plan.

Most of them will welcome the opportunity to move rapidly to work. But for those who refuse to train for work, look for work, or accept work once it is offered, the consequences are clear: Cash assistance will first be reduced, then eliminated.

We also believe that people who can work should be treated differently from those who can't. And here is where I draw a sharp distinction between our approach and the Personal Responsibility Act.

In 1988, Congress passed and Ronald Reagan signed the Family Support Act, which established the important principle that welfare should be a transitional system leading to work. Education and job training were to be required for most job-ready applicants.

Unfortunately, over one-half of the caseload was exempted, and, among those who were not, only twenty percent were required to participate. For example, broad exemptions were made for women with <u>any</u> child under age three, young mothers under age sixteen, and women in the second trimester of pregnancy.

We believe that these exemptions should be significantly narrowed, but we have suggested exemptions for people with disabilities or for those who need to care for disabled children. Temporary deferrals also would be narrowed: Twelve months for the birth of a first child, and twelve weeks for the birth of a second.

In addition, under our approach, once people reach their time limits, if they are able to work but can't find jobs, we require them to work for their benefits in temporary subsidized jobs.

This also sends an important message -- it says to people on welfare and to their children that work is an expected and necessary part of life and one of our society's greatest values.

In contrast, in the Personal Responsibility Act, all adults simply are cut off from assistance after two to five years, even if they are willing to work but can't find jobs, are providing full-time care for disabled children, or are unable to work because of disabilities.

Moreover, this is a lifetime limit: Once adults reach their limits, even if they go to work for many years and then lose their jobs during a recession or due to illness, they cannot get aid.

The second key value in our approach is responsibility.

We believe that because every child has two parents, both of them should be required to support their children.

That's why we have proposed the toughest child support system ever. Both parents must live up to their responsibilities -- and child support enforcement is an integral part of welfare reform.

Today, 63 percent of absent parents contribute no child support, and an average parent who receives child support receives a total of only $2,995 a year.

That's just $8 dollars a day for a parent who's lucky enough to get child support, and nothing at all for the majority of single parents and children who have been financially abandoned.

These are shocking statistics.

Overall, the potential for child support collections is estimated at $48 billion per year. Yet only $14 billion is actually paid, leading to an estimated collection gap of about $34 billion.

We must close that gap -- and we will.

We have proposed a comprehensive child support strategy to help custodial parents escape welfare and stay in the workforce.

It includes a tougher, more uniform child support enforcement system, as well as a stronger requirement for paternity establishment.

We also would impose tough new penalties for those who refuse to pay: Wage withholding, suspension of drivers' and professional licenses, and even property seizure.

In stark contrast, the Personal Responsibility Act includes few child support enforcement provisions and could actually reduce resources for enforcement by capping funding for child support enforcement and other low-income programs.

The Family Reinforcement Act does include some minor changes in the rules governing interstate enforcement processes, but, by themselves, these changes would do little to increase collections.

We must do much more. That is why child support enforcement is a central part of the President's approach. Governments don't raise children, parents do.

Moreover, attempting to implement welfare reform without strengthening child support enforcement sends the wrong message: It says that the non-custodial parent who is one-half responsible for the birth of a child does not have any responsibility for supporting that child.

In addition, our approach would deny AFDC benefits to the mother only after the state has determined that she will not identify the father.

Once the state determines that the mother has identified the father, then the responsibility properly rests with the state to establish paternity. We give the state one year to establish paternity or face penalties.

The Personal Responsibility Act denies benefits to any child for whom paternity has not been established -- whether or not the mother has identified the father, whether or not the state has made a serious effort to locate the father, and regardless of how long ago the child was born.

One of the most basic ways to reinforce responsibility is to hold the right person accountable: What sense does it make to hold children accountable when, in fact, their mother has cooperated and the state has not done its part to establish paternity?

I hope we can work together to address this issue.

In our approach to welfare reform, we expect individual responsibility, but we also demand responsibility and accountability from government. That's why our approach requires states to work with the federal government in implementing new, state-of-the-art anti-fraud measures.

These new systems are designed to detect and prevent many types of fraud and abuse, such as unreported employment and earnings, misrepresentation of the numbers of children in a family, and duplicate receipt of welfare, food stamps, unemployment compensation, and other government benefits.

These new systems also will help to locate absent parents who are not paying their child support.

The Personal Responsibility Act does not create any of these systems; in fact, it reduces funding for anti-fraud efforts.

The final bedrock value in our approach to welfare reform is the importance of reaching the next generation.

By that, we mean putting into place preventive measures to break the cycle of dependency and ensure that future generations don't pick up where their parents left off.

A key to doing that is taking a strong stand against teen pregnancy.

We recognize that welfare dependency could be reduced significantly if young people delayed childbearing until both parents were ready and able to assume the responsibility of supporting and raising children.

That's why our approach requires that a minor parent live at home, identify her child's father, and stay in school to get benefits.

Our plan of time limits and work requirements sends a strong message to young people that welfare will never be the same. From now on, welfare will be a second chance, not a way of life.

But we strongly disagree with the approach taken in the Personal Responsibility Act, which would be to deny benefits to children born to mothers under age 18 -- whether or not their parents are able to work, and whether or not they're properly caring for their young children.

Ironically, under the Personal Responsibility Act, those mothers can receive aid for themselves and additional children if the children are born after the mothers turn 18 (or 21 at state option).

The question we have to ask ourselves is what would happen to the hundreds of thousands of children who would be denied aid by this provision -- and the millions more who could ultimately be denied assistance because of other sections of the Personal Responsibility Act.

The Personal Responsibility Act suggests sending them to orphanages. We are convinced that this proposal is both wrong and unworkable.

It will divide families when we should be strengthening them. It will let teen fathers off the hook when we ought to be holding them accountable. And it could lead to more poverty, more spending, and more bureaucracy at a time when we desperately need less.

According to the Child Welfare League of America, the average annual cost per recipient of orphanage care is $36,500 per child. We estimate that the federal AFDC savings from the Personal Responsibility Act returned to the states could fund fewer than 9,000 orphanage slots for the entire country -- all fifty states!

Even if we add in all state and federal dollars for AFDC recipients on AFDC, Food Stamps, WIC, the school lunch program, and housing aid, the average benefit per recipient amounts to only about $3,300 per year. The Personal Responsibility Act returns far less than that.

So, what will happen to the other children?

Of course, we're not suggesting that all of them will wind up in orphanages.

In fact, some parents will move on to lives in the mainstream.

But, for those who cannot do so, there are several things that could happen.

First, states could pick up the bill for orphanages at $36,500 per child -- potentially a huge cost shift to states.

States could try to expand the already strapped foster care system -- but foster care costs $10,950 per child per year and is four times the cost of caring for a child in the AFDC program.

Or, governors and citizens could hope and pray that private charities or the children's other relatives rise to meet the demand.

We don't believe that's right or realistic.

The solution to welfare is not to make children go to orphanages, it's to make their parents go to work.

We must take bold steps to tackle the problem of teenage pregnancy -- but that does not mean that we should give up on teenage parents.

To be eligible for support, we must insist that they stay in school, live at home, and prepare for work.

We know that there are abstinence-based programs that are working in communities all over this country.

We must give more of those programs a chance to succeed.

All of us must be part of a national effort against teen pregnancy, and make it clear that young people should not become parents if they are not prepared to take responsibility for their children's futures.

Teenagers must be discouraged from having children, but if they do, they must also get the help they need to become good providers and role models.

That is to say, welfare reform must strengthen families, not weaken them.

It should help young mothers and their children escape welfare, not support long-term dependency.

That is why the President's approach would require work, not encourage orphanages; put a two-year time limit on welfare benefits and then insist that recipients go to work; devote more resources to child support enforcement -- not less; and mount a new effort to fight welfare fraud.

The American people deserve a government that honors their values, spends their money wisely, and rewards people who work hard and play by the rules.

We stand ready to work with this Committee and this Congress to make these values the centerpiece of welfare reform.

I am hopeful that as these issues are debated we remain committed to seeking bipartisan solutions through an open dialogue that will benefit all Americans.

Mr. Chairman, as we join forces to move people from welfare to work, we will need to address the bureaucratic absurdity and human tragedy of "welfare lock," which occurs when people who want to work go on welfare or stay on welfare because they do not have health insurance and therefore need the services provided by our Medicaid program.

The way to address this tragedy is to make sure that all working families have access to affordable private health insurance.

This will require some reform of our health care system, which is another area where this Administration has taken up the people's call for change.

Health Care Reform

While we are disappointed that we could not achieve broad-based agreement on a health reform initiative in the 103rd Congress, there can be no disagreement on the fact that we still face the enormous problems of increasing health care costs and decreasing coverage.

The Administration remains firmly committed to providing insurance coverage for every American and to containing health care costs for families, businesses, and Federal, State, and local governments.

As the President has said, in this session of Congress, we can and should take steps toward achieving these goals.

We can pass legislation that addresses the unfairness in the insurance market, makes coverage more affordable for working families and children, assures that the populations served by Medicare and Medicaid are protected, reduces the long-term Federal deficit, and strengthens tools available to combat health care fraud, waste, and abuse.

We stand ready to work with the 104th Congress in confronting these challenges on a bipartisan basis.

Long-Term Care

Another health challenge we must face is long-term care.

On long-term care, we continue to endorse assistance to states to develop home and community-based care systems that support people with disabilities, regardless of age, condition, or income;

that strengthen families' abilities to care for their disabled family members;

and that allow flexibility so that states and communities can tailor services to their specific needs.

Such support is an essential component to assuring the availability of services for people with disabilities throughout our country.

Alongside promotion of home- and community-based care, we support changes in the tax code that would give long-term care insurance (and services) the same preferred tax status as standard health insurance, provided that insurance policies meet certain consumer protection standards.

While we agree with the notion of extending preferred tax treatment to long-term care insurance, we feel strongly that insurance should include information and be marketed in ways that help seniors understand the benefits and limitations of insurance policies.

We also agree with the notion of helping caregivers, but the tax credits proposed in the Contract may not be the best way to target limited resources to caregivers and families in need. We may be better able to help caregivers and people with disabilities with grants to states for services tailored to community needs. We look forward to working with you on this.

Balanced Budget Amendment

All of the policy issues I have discussed today would be profoundly affected by the provision in the Contract with America that would require all federal budgets to be balanced in the year 2002 and afterwards.

Let me be clear: While we support the goal of a balanced budget, the proposal that is included in the Contract would require an unprecedented level of reductions in our programs -- including Medicare, Medicaid, SSI, Head Start, and NIH research.

This is because all of the savings likely would have to come from the domestic spending side of the federal budget.

If Social Security is protected as some have promised, and defense reductions and tax increases are not on the table, all other domestic spending programs, including those at HHS, would have to be reduced by 28 percent. Such reductions would drive millions more families into poverty.

Analyses conducted for my Department by the Urban Institute suggest that even a 20 percent cut in our programs would reduce incomes for over seventeen million individuals and families and result in 3.7 million additional people being on the poverty rolls.

We should not forget that our Department also has responsibility to ensure the safety and health of all Americans through the work of critical HHS agencies charged with protecting the public health. The cuts that could be required under the Contract proposal for a balanced budget could seriously jeopardize our capability to meet these obligations.

Conclusion

Mr. Chairman, we in the Administration look forward to working closely with you and your colleagues in the new Congress.

We still have a big job ahead of us as we work to improve health care for the American people by promoting health insurance security and containing costs.

And, in welfare, we must work together to put in place a system that moves people from welfare to work, that protects children, that rewards people who work hard and play by the rules, and that holds parents accountable.

I believe that we have a rare opportunity -- on welfare and many other issues -- to move this country forward, to help all Americans, to renew our people's faith in government.

Just as it's time to end welfare as we know it, we also must end politics as we know it.

We're ready to sit down and work with this Committee, this Congress, elected officials across the country, and the American people to get the job done. Thank you.

Chairman ARCHER. Thank you for your testimony.

The Chair will yield his time to the ranking Republican, Mr. Crane, for inquiry.

Mr. CRANE. Thank you, Mr. Chairman, and Madam Secretary.

Madam Secretary, in your statement you indicated that the Personal Responsibility Act suggests sending children to orphanages, and I was wondering where in the act you came to that conclusion.

Secretary SHALALA. I suggested that one of the alternatives suggested in the Personal Responsibility Act is orphanages, and it is listed in the bill, and money is provided to the States.

The point I made both in my press conference and here again is that large numbers of children are turned away from the welfare rolls because their parents are teenagers, and the question that I raise is what will happen to these children.

Mr. CRANE. Well, on page 25 of the bill it says use of grant funds. And under that provision it says each qualified State that receives grant funds shall use these funds, one, to establish or expand programs to reduce out-of-wedlock pregnancies; two, to promote adoption; three, to establish and operate orphanages; four, to establish and operate closely supervised residential group homes for unwed mothers; or, five, in any manner that the State deems appropriate to accomplish the purpose of this part.

There is no effort in the Contract to insist that kids have to be placed in orphanages. That is a State decision and has been a State decision, and all the Contract attempts to do is to provide some direct grant funds.

Secretary SHALALA. And outlines orphanages as one of the options that is available to the State.

Mr. CRANE. Well, to be sure, and it is right now, has been.

Secretary SHALALA. I think we are consistent. I think we are saying the same thing.

Mr. CRANE. Well, except your statement is a little bit misleading in that it says the act suggests sending them to orphanages.

Secretary SHALALA. The act suggests that one option available to the States is for the States to establish and operate orphanages. The point——

Mr. CRANE. Which States do right now.

Secretary SHALALA. Some States operate alternatives for at-risk children.

The point I was making was a point about what is going to happen to millions of American children who are not eligible for support because their parents happen to be teenagers.

Mr. CRANE. Well, do you see any inconsistency with current law in this provision in the Contract?

Secretary SHALALA. Well, the inconsistency with current law is that current law does not throw millions of children or does not exclude millions of American children who are born to teenagers and born into poverty, into destitution or—on to the hands of the States without any Federal support at all and then give a limited amount of money to the States, which is what this proposal does, to deal with a variety of different kinds of options.

Mr. CRANE. Well, I was going to say all under the provisions of the Contract that is gone is AFDC. The other benefits are still available.

Secretary SHALALA. Benefits are not available to children of teenagers, to children born of teenagers under the Contract's provisions would not be eligible, their parents and they would not be eligible for aid.

Mr. CRANE. Why do you believe that to be the case? What language in the Contract?

Secretary SHALALA. Under our original analysis of the bill—and I could give you the page numbers of the bill—5 million children would lose AFDC eligibility under the original Personal Responsibility Act which was presented to the public with the Contract in September. Now, there were some recent changes made to the legislative language that would no longer make this provision retroactive. Our analysis of the revised bill shows that almost 1.3 million children would lose their eligibility for AFDC the first year of implementation if the States adopt the least restrictive option available to them.

So the issue that I raise is what is to happen with millions of American children who are not eligible for aid because they are born to teenage parents? And the only options presented in the bill is this list of options for those children, and those are the resources that are provided by the Federal Government under the bill.

Mr. CRANE. There is no provision, Madam Secretary, in the bill that is retroactive.

Secretary SHALALA. No, that is correct, and I indicated that. However, in the first draft there was such a provision. In the second draft, which is the new legislation, H.R. 4, that provision has been deleted. But what I have said is that in the first year of implementation, even without the retroactivity, assuming that the States took the least restrictive approach, that there would be children that would be born to teenage parents who would be ineligible for aid.

Chairman ARCHER. The gentleman's time has expired. Mr. Gibbons will inquire.

Mr. GIBBONS. I will yield to whatever Democrat is eligible.

Chairman ARCHER. Mr. Gibbons yields to Dr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

Secretary Shalala, this country in the thirties had a system of orphanages and workhouses at the local level. The national program that we now call welfare really grew as a response to that failure of that system. Can you explain to me why the Governors of this country are coming in here saying they want to take welfare back and get less money from the Federal Government? How are they going to provide a better system than they presently have with less money? Because they surely will get less money with these caps that are in the Contract With America.

Secretary SHALALA. I cannot explain it, Congressman McDermott. The only thing I can suggest is that I don't think that all the Governors have looked at the implications of either the proposal they are negotiating or what exists in the Contract because they are giving up the flexibility of the program to respond to economic changes in their States. And they are agreeing, depending on whether they agree with the Contract or in their own negotiations, on block grants with a program that may well exclude Federal money from large numbers of children.

What would happen to those children in their States? I can't come to a conclusion. My hope is, knowing some of the Governors, that this is the beginning of a longer conversation about the implications of this proposal, of the President's proposal, and we will go back to the principles. The principles of all this are work and responsibility, making parents take responsibility for their children and turning the program a complete turn to make it focus on a transitional program to get people into work.

Mr. McDERMOTT. Are you suggesting that it is good national policy that a child born, let's say, in the State of Florida where they might have a humane Governor ought to be treated better than a child who is living in the State of Michigan where the Governor is less humane? Would there be any fairness in the arbitrary system that would result from giving welfare back to the States?

Secretary SHALALA. Congressman, welfare has been a Federal-State partnership. We have left some of the setting of benefits to the States. That would continue under the President's proposal as he has laid it out.

The fundamental issue that you are raising is what is the responsibility of government for the children in this country. Should there be some minimal benefits available for every child so that a child born in Mississippi doesn't go hungry because the State is poor versus a child born in Michigan or in my own State of Wisconsin? Is there a minimal role for national standards and national framework?

And that is essentially the real core of the welfare debate. And the President and this administration has concluded that there is indeed a place for the National Government in a partnership with the States.

We have also conceded and enthusiastically supported the efforts by the Governors to get more flexibility in designing the programs themselves. And no one can accuse us, having approved over a 2-year period, 24 waivers, of not helping the Governors to find and explore ideas that they want to test for moving people from welfare to work.

So it is a fundamental issue. It is the most fundamental issue. I would argue it is what defines us as Americans on what the role is of the National Government versus the State governments and what that partnership is about.

Mr. McDERMOTT. I would like to raise one other question, and that is as I read these proposals—and I am not sure which proposal they are finally going to roll out here—but the proposals look to me to be very sexist. The proposal says we will punish women for having babies, but we won't really go after the fathers who fathered the children. It is very clear that there is an unbalance, and I wonder about your position on that.

Secretary SHALALA. Well, as I indicated in my testimony, I was disappointed that the Personal Responsibility Act, the Contract did not have more on child support enforcement because there are members of this committee on both sides who have spent part of their careers fighting for very strong child support enforcement measures. And, Mr. Chairman, I hope that that is one of the things that we can work on to make sure we don't move ahead with a welfare reform bill that doesn't hold both parents responsible and make sure that both parents take the responsibility for both providing resources as well as nurturing the children. And that needs to be a very important element that is introduced as part of this effort, Congressman.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

Chairman ARCHER. I will assure the gentleman from the State of Washington that on this side of the aisle we intend to go after the fathers and see that they are responsible for taking care of their children. It is a major thrust of our effort.

Mr. Ensign will inquire.

Mr. MCDERMOTT. I would just say, Mr. Chairman, I don't see that in the proposal yet, and I hope that you would.

Chairman ARCHER. You can believe that we intend to do that.

Mr. Ensign will inquire.

Mr. ENSIGN. Secretary Shalala, the concern that I have with the administration's welfare proposal and actually with a lot of the proposals coming out of Washington and at the State level, is that when you are trying to design a system that has make-work type programs, job training, and so on, we have programs where an individual can get around the various requirements, such as in job training.

Has anybody put a pencil to it in the administration? How long someone could actually stay on welfare without actually going to work, going in and out of some of these job training programs, but actually not fulfilling the spirit of what you are intending to do?

Secretary SHALALA. In the President's proposal, 2 minutes, and that is——

Mr. ENSIGN. No. How long could they actually continue receiving benefits while actually not legitimately going after work?

Secretary SHALALA. In the President's proposal, the maximum is a 2-year period in which someone would prepare for work. That is excluding a teenager that would have to finish high school first.

And so what I meant by the 2-minute response is from the moment someone walks into a welfare office, the purpose of that welfare office—and we need to change the culture of that welfare office—is to get people ready to go to work. For some people, it literally will take a few weeks to get ready and to do the job search because they are job ready. For other people, it may take up to 2 years of some kind of a training program.

We recommend an employability plan, an actual contract, with the kind of contract with the individual that lays out what the expectations are. And my point here is that the goal must be to move people into private-sector jobs.

In our proposal there are subsidized jobs only if the State certifies that there are no private-sector jobs, and those public-sector jobs are temporary jobs while the person continues the search. Those public-sector jobs are temporary jobs as the person continues the search for a private-sector job. Our goal is to move people into private-sector jobs.

The timeframe that we have put together is based on research in this area. So for many people it may be 3 months.

We know something about people getting off welfare: 70 percent get off in 2 years; 90 percent get off in 5 years. The problem is staying off of welfare. Some of that is related to child care. Some of it is related to health care. And some of it is related to the kind of job readiness expectation piece of it.

Mr. ENSIGN. Would your proposals in the administration be just new people coming into the system? Or would people, everyone existing in the system now, be also required to get into work programs and training programs?

Secretary SHALALA. Well, it is interesting. We had originally recommended when I first testified before this committee last year that we start with the youngest people. That is the most high-risk group. The proposals that are in the Contract, some of them suggest that we start with the older people because, frankly, you will be more successful.

All the research shows that you will be more successful with the people that are currently on the system that have been for a period of time, where their children are older, for example.

We have come to the conclusion, after listening to the Governors, that this is exactly one of those issues, and in fact we put the flexibility in our own first draft of the plan that we actually introduced, that it is really up to the Governors on what group they want to start with.

For some States, it may make sense when they look at the profile of their older population. For other States who want to deal with the teenage pregnancy thing immediately, they may want to put their resources—it really is a resource question. There are States in this country where the Governors will grab these reform proposals and do it for everyone and immerse everyone in the program. So it clearly is one of those issues where in conversations between us I think we all probably end up letting the Governors do that kind of design because that is one of those appropriate things.

Mr. ENSIGN. Thank you.

Secretary SHALALA. You are welcome.

Chairman ARCHER. Mr. English will inquire.

Mr. ENGLISH. Thank you.

Secretary Shalala, in your testimony you state that the Personal Responsibility Act is flawed because it would actually reduce resources for enforcement by capping funding for child support enforcement and other programs. I was wondering, could you please clarify for this committee the programs that you feel should not have spending limitations?

Secretary SHALALA. Child support—it is not a question of spending limitations; it is a question of providing appropriate resources so that we can get the job done. And what we need to do—and it seems to me in conversations with the Governors and with other people that deliver these programs and decide what are the principles we are trying to achieve I would suggest that holding both parents responsible is a very important principle. And, therefore, child support enforcement ought to have the kind of investment that is necessary to put the national program out there that will do the job for us. And we have enough experience State by State to have some sense of what that would cost.

I would also suggest that we ought to have a serious program on waste, fraud and abuse, that part of the principles of making certain that we have the credibility that we need with the American people is to make sure that we have put in place an effective system to reduce waste, fraud and abuse, whether it is a computer system that connects up across States, in regions, as we have tested in certain parts of the country. But we need to make that kind of investment.

I am not saying——

Mr. ENGLISH. Those are principles, Madam Secretary——

Secretary SHALALA. Pardon?

Mr. ENGLISH. I guess I should reframe the question. Where in our welfare reform legislation, our welfare reform proposal, would you be willing to accept Federal spending limitations?

Secretary SHALALA. The Federal spending limitations in our proposal, the Federal spending limitations are based on putting time limits on the periods of time that people can invest and budget limitations on the investments. We have made our proposal budget neutral, and the decisions about how much child care, for instance, to put in place is part of the proposal. So we have submitted a budget-neutral proposal.

What I am suggesting, in answer to your specific question, is that by lumping together a set of programs, some of which may be priorities that ought to be fully funded and others ought to be the choices of Governors, we ought to make some of those decisions. And I, in particular, believe that child support enforcement and waste, fraud and abuse ought to be two of those.

Mr. ENGLISH. Thank you. Can you—can the administration support any restrictions on additional AFDC benefits specifically for those already on welfare who have additional children?

Secretary SHALALA. We have in the welfare waivers—we have in our own proposal left that decision to the States, and we have approved in welfare waivers from one end of this country to the other limitations on additional money for a child born while the person was on welfare. So we have been consistent both in the President's recommendation as well as in our approval of waivers.

Mr. ENGLISH. How would you feel about writing that in as a standard in Federal legislation?

Secretary SHALALA. Our preference—we have indicated that our preference is that that decision be left to the State and to the Governors and to the representatives of the State. It is, as you know, a very sensitive issue. We are consistent. The Federal-State partnership has always allowed the States to set the budget, the spending limitations in terms of the payments, but our preference is to leave that decision to the State.

Mr. ENGLISH. Thank you. Madam Secretary, what is the position of the administration on encouraging through Federal legislation the random drug testing of welfare recipients?

Secretary SHALALA. We have supported welfare recipients being mandated as part—for addicts as part of the requirements of the job to go into drug treatment programs. Most of those drug treatment programs actually have testing as part of them, and we have accepted that as part of the drug testing programs.

Anything beyond that I understand—and I am not a lawyer—raises some constitutional issues, and we would be happy to explore that with the committee. But as part of the requirement for a welfare recipient to be in a drug treatment program, and that being built in as part of the program, we have been supportive.

Mr. ENGLISH. Thank you, Madam Secretary.

Secretary SHALALA. You are welcome.

Chairman ARCHER. Mr. Neal will inquire.

Mr. NEAL. Thank you very much, Mr. Chairman.

Madam Secretary, I had the chance a few months ago to ask you that famous Murphy Brown question here, and you shed new light on it. I want to thank you for that, and I thought you did a very good job this morning.

You focused on four areas that I think we all ought to be able to agree on: The minor ought to live at home; that we ought to identify the father; that we ought to encourage, if not require, work; and that we certainly ought to encourage staying in school. In fact, we ought to insist upon those options.

I would suggest today that every member of this committee, as we begin this debate on welfare which is surely to be contentious, make reference to an April 1993, article that appeared on the cover of the Atlantic magazine by Barbara Dafoe Whitehead. While the article is entitled, "Dan Quayle Was Right," the truth of the matter is that Pat Moynihan was more right 30 years ago, and we haven't come very far in advancing those arguments.

I just want to suggest to you today that this is an item that I think belongs on the front of the American agenda for Democrats and Republicans alike. There is nothing—and I served as mayor of a big city before coming to Congress a few years ago—there is nothing that has done more to destroy the reputation of urban living than the current framework of welfare. It is linked to crime. It is linked to a lack of adequate health care. It is linked to the issue, in my judgment, of the deterioration of the American family and its current fate.

I think you and the President deserve credit for having had the courage to force some debate on this issue. You have taken positions, and I think those positions are clarified for the American people that we are going to find a lot of common ground here on both sides of the aisle.

I would hope that we wouldn't shrink from this notion here of identifying the father. I think that ought to be the cornerstone of our initiative on the Democratic side. And this can be done—and there is evidence in Massachusetts where there are experiments that have taken place that that can be done far more aggressively.

So my point in using this time, this short time I have, is to give you a chance to go on about those initiatives but most importantly to thank you because I think you have been forthright, I think you have been very candid with us, and I think the options you have laid out for us today ought to be options that everybody on both sides of this forum can agree on. Thank you.

Secretary SHALALA. Thank you very much, Congressman.

Let me repeat the issue of paternity because I think it is very important here the differences between the President's proposal and what, unfortunately, is in the Contract because I have a feeling that this committee will come down somewhere near where we came down.

What happens in paternity establishment is that the mother is asked to identify the father, and before anyone gets on welfare they are asked to do that in all of the proposals. The issue is then whose responsibility is it to establish legal paternity.

We have argued, and it has been consistent around the country, then the State must follow up. The mother fully identifies the father, gives his address, all the information she can—the baby may have been born a number of years ago—and then the State must follow up. Some States are very good about following up, they do it immediately, and we hold them accountable to do it within 1 year.

The issue is while the State is following up should the child be penalized and not be able to get aid because the State doesn't have its act together and has a bureaucracy in which it hasn't followed up? When the mother has done what is expected of her, when we argue that the current welfare system has its values all messed up, we have got to get the values right this time.

And our argument here is if the mother has followed all the rules that we have laid out, she has identified the father, should she and the child in particular be penalized because the bureaucratic mechanism of the State has not followed up for the legal establishment of paternity?

Most people don't understand this. They think the mother just isn't identifying the father. But our point is once she has done that to the satisfaction of the State, it is only fair that she get some temporary help for that child while she gets ready to go to work.

Again, it is a fairness issue, but we must get the values right this time. We cannot get all confused about our values in terms of who is responsible. The responsibility must be both of the parents as well as the institutions themselves, and in this case the State as well as the Federal Government.

Mr. NEAL. Thank you.

Chairman ARCHER. Madam Secretary, if I may jump in here very quickly. I would like to ask you two brief questions. Number one, what percent of the welfare recipients will be covered by your work requirement in your proposal?

Secretary SHALALA. In the President's proposal?

Chairman ARCHER. Yes.

Secretary SHALALA. Well, it is phased in over time. What we have done in the President's proposal is narrowed down the number of exemptions that are allowed. We are somewhat more flexible than what is in the Contract. The Contract, for instance, does not allow for an exemption for a mother that is taking care of a disabled child. We would actually allow for an exemption for a mother that is taking care of the disabled——

Chairman ARCHER. I am sure others will inquire as to the details. I just simply wanted the percentage.

Secretary SHALALA. Well, we provided enough money to start phasing in the program, and the first group that was phased in were all of the youngest recipients who are under 25, and I will have to give you the percentage.

Chairman ARCHER. But can you tell the committee the percentage of the recipients at the beginning and the percentage at the end?

Secretary SHALALA. Yes, I will give you that number right now.

Chairman ARCHER. While you are getting that information, let me ask another question. In the event that a welfare recipient does not show up for work and fails to comply with the work requirement, what sanctions do you contemplate?

Secretary SHALALA. We start by reducing the benefits. And, eventually, if someone does not play by the rules, does not show up for work, does not show up for their schooling or their educational training, they can be cut off of the program.

We expect people who play by the rules to have the opportunity to move into a private-sector job or a public-sector, subsidized job if necessary for a short period of time, but we are tough minded about people that are unwilling to participate in getting ready for work or to take a job when offered.

Chairman ARCHER. I assume that there would not be any great leniency for people calling in sick or having excuses for failing to show up for the work requirement?

Secretary SHALALA. I think that what is important, Mr. Chairman, is that the work requirements for workers in the United States are the same work requirements that we have for the welfare group that is moving in to work. The reason that we are so anxious to have people earn a paycheck and not simply work off their welfare is to make a very simple point, that what we are trying to do is to move people into real private-sector jobs where they get a paycheck.

Chairman ARCHER. I understand that motivation, and of course I think most all of us would agree with that, but I am just curious specifically as to the sanctions. You have said, as I understood you, that all welfare benefits would ultimately be taken away from these people.

Secretary SHALALA. Can be taken away if people do not——

Chairman ARCHER. Then what happens to the children?

Secretary SHALALA. We cover the children.

Chairman ARCHER. How do you cover the children?

Secretary SHALALA. With Medicaid and with food stamps and with——

Chairman ARCHER. You continue to give those to the mother?

Secretary SHALALA. We continue to give them to the mother for the child. And we cover AFDC, right? I think the fundamental—I have got the phase-in numbers, too.

Let me say that a parent that is unwilling to play by the new rules under the welfare reform proposal, who is unwilling to do what is necessary to get into a private-sector job, that gets both the sanctions as well as in a relatively short period of time perhaps the benefits taken away, that those children eventually—within that period of time, the child welfare system has to take over because, again, this is an issue of responsibility. If a parent is not prepared to take responsibility, then the child welfare system must move in to take responsibility for those children.

I do have your phase-in——

Chairman ARCHER. So you contemplate that under those circumstances the children would be taken away from the parent by the State authority and be taken care of perhaps in an orphanage or in a foster home or something of that nature?

Secretary SHALALA. There would be a number of options that are available if the parent doesn't fulfill their responsibility under the welfare reform plan. Under our plan, one-third of the recipients are phased in immediately, we reach one-half in 5 years, and everybody is phased in eventually. All of that depends on the financing of the system, the financing we presented, which was about a $10 billion bill. If there were more resources available, we, of course, could do this more quickly.

This phase-in plan, which was discussed with the Governors in terms of what they thought they could absorb and to make the kind of dramatic changes that are necessary, was very much part of the decisionmaking in our proposal. There is no question if there were more resources available we could phase-in more quickly if that is what the States had the capacity to do and were prepared to do it.

Chairman ARCHER. OK. Now let me be certain about this. Your plan does contemplate that where the mother refuses to comply with the work requirement that the children can be taken away from the mother. If you take away the AFDC cash benefits from the mother, you take away the source of support for those children. Under those circumstances, if the children are to have adequate monetary support, I hear you saying that the State could then take the children away from the parent and that the children then, I assume, under current law and under your proposal could be put in orphanages. Is that not correct?

Secretary SHALALA. Let me repeat.

Chairman ARCHER. No, but is that correct? Is that or is that not correct?

Secretary SHALALA. The children would be taken into the child welfare system. In foster care, in some cases put into an adoption situation, in some cases put into group homes depending on their ages.

Chairman ARCHER. Could they be put into orphanages is my question.

Secretary SHALALA. Well, they wouldn't be put into 19——

Chairman ARCHER. Not would they, could they be?

Secretary SHALALA. If they were babies, it is likely they would not.

Chairman ARCHER. Could they or could they not be put in orphanages? It is a very simple question.

Secretary SHALALA. If they were teenagers they could be put into group homes, which is the modern version of residential settings for children.

Chairman ARCHER. If they were less than teenagers, if they were preteens, could they be put into orphanages by the States under your program?

Secretary SHALALA. Most of the residential settings in this country, most young children are put into foster care in this country. Most of the residential homes are for slightly older children, but——

Chairman ARCHER. Could they be put into orphanages by the State? That is a simple question. Yes or no?

Secretary SHALALA. As part of the overall series of options that a State has before it, the answer is yes.

Chairman ARCHER. Yes.

Secretary SHALALA. But they would not be put in there because they were born to a teenage mother who was willing to work, who was willing to go to school, who was willing to stay at home. There is a difference between cutting off large numbers of children because they were born to a teenager.

Chairman ARCHER. I understand. Simply put, under the sanctions contemplated in your proposal, children could be put in orphanages, is that correct?

Secretary SHALALA. Some children could be put in residential settings. No one is calling them orphanages.

Chairman ARCHER. You can call it whatever you want to, but that is the reality as I understand your proposal. I appreciate your testimony, and I thank the committee for their indulgence.

The Chair recognizes Mr. Christensen to inquire.

Mr. CHRISTENSEN. Thank you, Mr. Chairman. I thank the Chairman for helping the Madam with the definitions there because, basically, you have already said that they could be put into orphanage homes.

I have heard a lot of rhetoric today mouthing the words of Ronald Reagan and Bill Bennett, a lot of talk about values, but I have seen very little in terms of action as far as the administration is concerned.

I want to be exactly clear on your proposal as far as when we send this back to the States that they will be allowed to form their own kind of program. Let me ask you, would a Governor be able to cut off welfare payments, for example, after 6 months rather than 2 years under your proposal?

Secretary SHALALA. If someone chose not to work, if someone did not participate in the program and chose not to work, could the individual be cut off? The responsibility parts are very clear. One is expected to participate in the program. So during the 2-year period, which is the period in which someone is given to participate, they could be cut off for not participating at all or refusing to participate in preparing for work or in searching for a job.

Mr. CHRISTENSEN. But could a Governor have discretion to cut off that welfare recipient based upon their own standards, not based upon your standards?

Secretary SHALALA. No. The answer is no because the standard is——

Mr. CHRISTENSEN. Thank you. So, really, the Governor——

Secretary SHALALA [continuing]. Work requirements.

Mr. CHRISTENSEN. So, really, the Governors will not have the discretion that you were implying here earlier?

Secretary SHALALA. Pardon?

Mr. CHRISTENSEN. The Governors will not have the discretion to formulate their own program as you have just stated here?

Secretary SHALALA. No, that is not true, and I think it is a bit unfair. One of the things that I pointed out is we have already worked with the Governors in over half the States where they have shaped programs to move people off welfare into work. And what we see the President's proposal as is providing a framework which is based around two—three principles actually. One is work and that everybody goes to work, and the other is the responsibility of the individual for getting prepared for work.

Mr. CHRISTENSEN. But if we send this back to the States for them to create their own program, basically you are going to tie their hands?

Secretary SHALALA. No, I do not believe that the President's proposal—I think it has enormous flexibility.

I think that one of the things we learned as part of the hearings and one of the reasons we are prepared and enthusiastic about working with this committee is that in 1 year working with the Governors on a number of these welfare proposals they clearly have indicated that there are other kinds of flexibilities they would like to have.

Mr. CHRISTENSEN. Madam Secretary, for example, if a State like Nebraska wanted to eliminate benefits for any additional children to teenage mothers.

Secretary SHALALA. They would be allowed to do that under the President's proposal.

Mr. CHRISTENSEN. Within the 2-year timeframe, 6 months, immediately? You name it. Could they do it right away?

Secretary SHALALA. They could do it right away.

Mr. CHRISTENSEN. Thank you.

Secretary SHALALA. You are welcome.

Mr. CRANE [presiding]. I think Ms. Dunn is next.

Ms. DUNN. Thank you, Mr. Chairman.

Madam Secretary, I am pleased by the fact that you have given waivers to 24 States during the last 2 years, and I agree with your emphasis on the Federal-State partnership. Certainly, our reform proposal is along that line.

What I would like you to clarify for me or perhaps contrast is the differences between the administration's proposal and the majority's proposal on what responsibilities would be retained by the Federal Government in this partnership.

Secretary SHALALA. The Federal Government would agree to pay its share of the bill under the partnership. One of my problems is—do you want me to talk about the contrast between the Contract or this new negotiation with the Governors, or—I am trying to figure out what bill I am comparing myself to. Let me give you——

Ms. DUNN. Tell me what the administration's proposal is on what responsibilities the Federal Government would keep.

Secretary SHALALA. The Federal Government would have a handful of responsibilities. One is that we develop a framework, and that is, every program must move people to work within a time-limited period of 2 years. The States would design the training programs, the employment programs. They would work with the recipients. They could put the recipients in their own training programs. They could contract out for the training programs they wanted to use. The whole process of getting people into job training—we have taken the recommendations, for instance, for teenagers to stay in their own home, to stay in school. Those come out of our welfare experiments from around the country. So those are consistent with what the Governors have been wanting to do all along. Again, that is part of a framework.

What the third piece of the Federal Government would do is work with the States to develop the child support enforcement piece, because there is a national piece to that as well as a data bank and other kinds of roles for the National Government. But the States would basically use resources to develop a kind of program that worked for them, though the basic information would have to be shared between the States if they were going to follow somewhat up.

So what we see the President's proposal, which has only a handful of elements on work and responsibility by both the individuals as well as the State, is providing the basic framework, and the States would design the programs to fit with how that State wanted to operate its program.

We have put a time limit on it. We have insisted on child support enforcement. We have insisted that teenagers stay in school and stay at home. We have left a number of things to the States' discretion, including, for instance, benefit levels as well as whether they want to continue to pay benefits to people who have an additional child on welfare.

Ms. DUNN. Thank you. Thank you, Mr. Chairman.

Mr. CRANE. Next is Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman, and welcome, Madam Secretary, and I want to first commend you and your department and the administration for the work you have done on this issue over the past 2 years. As my colleague Mr. Neal said earlier, certainly you have moved this debate forward so that we are in a position to act on this very quickly, I would hope.

Let me go back to some things you said in your testimony and then I have a question. You stated that 63 percent—this has to do with child support enforcement—63 percent of the absent parents contribute no child support—63 percent. The potential then in the country is that there are now on an annual basis $48 billion that should be paid in child support, yet only $14 billion are currently paid, leaving $34 billion uncollected that is available for our children in this country.

You then in your statement mention that the Personal Responsibility Act could actually reduce the resources for enforcement because it does cap the amount of money that is available for child support enforcement.

I was very pleased to hear the Chairman, Mr. Archer, say that he felt that was something we needed to work on in a bipartisan way, and I feel that is the way we will get the very best welfare reform, is to work on this in a bipartisan way.

My question, though, really has to do with fiscal responsibility and money and back to the $34 billion that is there that could be collected. Some of this money now our taxpayers are paying in lieu of the people who should be making these payments. Is there any estimate concerning how much exactly that is? How much money might be made available to assist us in welfare reform if, in fact, we were able to implement the collection programs that you anticipate?

Secretary SHALALA. I think the number is 25 percent, that there would be a 25-percent reduction in current welfare expenditures if we were able to collect from the parents.

As you probably know, I am sure you do know, most of the noncustodial parents who have not paid child support are not the fathers of children that are on welfare; that we have a large number of noncustodial parents whose children are not on welfare, but simply are not living up to their obligations.

So the child support enforcement piece should be seen not simply as part of the welfare effort in this country, but part of our effort as a country in partnership with the States to make certain that the children in this country are supported by both parents.

So I think that our enthusiasm for doing this in the context of welfare reform is that while it is significant for welfare reform on expenditures, it is more significant for us as a country to hold both parents responsible and to be clear about responsibilities for parenting.

Mr. PAYNE. And this is money, though, that would be returned to families, just as any kind of tax reduction that we are discussing would also be returned to them?

Secretary SHALALA. And it would make a difference of lifting families out of poverty.

The proposal that we have made would also move this out of the courts, which will get clogged into an administrative procedure with regular updates, perhaps every 3 years. And I know that a number of people here have worked on this issue on both sides of the aisle, have worked on the child support issue, and I am very pleased that the Chairman has agreed this is something that we can work through.

I think child support enforcement, paternity, there are a number of issues here we ought to be able to work on together.

Mr. PAYNE. I agree with that and thank you very much, Madam Secretary.

Secretary SHALALA. You are welcome.

Mr. CRANE. Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman.

Madam Secretary, I look forward to working with you and the administration on this particular issue, and I note in your testimony that you—your written testimony—you mentioned writing a new chapter in bipartisan government. I would like to work on that with you, but I do believe we are going to need more direct responses from you.

Your testimony, in some ways, was misleading, and I am glad, in response to Chairman Archer, that we did establish that both the administration bill and the majority bill will terminate the custodial parent's AFDC benefit at some point. We may differ as to when and how, but both bills are similar in that respect.

Second, the suggestion that the majority welfare bill in our Contract With America sends children to orphanages is absolutely wrong. And I think it has been clarified to some degree, but under current law States may send children to orphanages or group homes. Under the administration bill States would continue to be able to do that, and under the majority bill, States would continue to do that.

I just think it is important to understand that we have similarities in our bills in that respect.

Last, you made a comment that the majority bill denied welfare benefits to the children of minors. And I just want to make it clear that the majority bill would continue to allow the children of a minor parent to receive, and the parent, him or herself, to receive Medicaid and food stamps, as I think the administration bill does.

We do change the nature of the AFDC in housing benefits, which would change to a block grant to the States, and the States then would be free—and I know you also agree with greater State flexibility—to establish programs for minor parents to replace the AFDC in housing grants.

The Washington Post has an editorial today that says that since election day politicians have been engaged in a largely self-serving debate about what to do with children caught in the welfare trap. Each side has been behaving as if it had discovered a political gold mine; each mischaracterizing the other's position. And I want to make it very clear as to what our position is, and, in some cases, we have greater similarities than your earlier testimony had made clear.

Thank you, Mr. Chairman.

Mr. CRANE. Thank you. Next is Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

Madam Secretary, like you, I am concerned about the proposal that Mr. Camp just talked about, and that is the denial of benefits to unwed teenage mothers.

My reading of the bill is the same as yours, Mr. Camp, wherein the dollars saved would be going to the States in block grants, at which time the State could use the dollars for programs to dissuade young females from getting pregnant, underage females; it would also permit the States to use the dollars for group homes, foster homes, and, like the Secretary, I think that the possibility should exist of a possibly reduced AFDC payment but one which would go to the teenager who remains at home.

Having been a State legislator, like probably most of us on this panel, and dealing with group homes and foster homes, those things do not come cheap by any stretch. If we can encourage the unwed mother to, one, remain at home; and, two, hopefully remain at school, I think the payment that goes in that situation will be well spent. But to put it in block grants and encourage group homes, I think we will be costing the taxpayers a lot of money and doing damage to society in the same respect.

Madam Secretary, would you like to comment on that?

Secretary SHALALA. Yes, thank you very much, Mr. Kleczka.

Let me simply say the difference between the two bills is when you get sanctions and what your behavior is to get the sanction. In our bill, the only time that an individual who is needy gets penalized is when they refuse to work. In the Contract, if you are a teenager and you have a child, you lose the possibility of getting a payment, a cash payment, in addition to the fact if you do not work you also lose it.

The issue is, is that fair? We all agree that teenagers ought to live at home, all of us. There is not anyone here who does not want to say to American teenagers and do everything we can to send the clearest possible message that they should not be engaging in sex in the first place, let alone getting pregnant. But the point here is should we, because a child is born to a teenager, because of the fact of age, because the child is born to a 17-year-old as opposed to a 19-year-old, arbitrarily make a decision that they should not get AFDC.

I am simply saying if we are going to get our values straight, that penalizing someone because they refuse to go to work makes sense, because those are the standards of the bills, but making innocent children suffer because of a teenager, a child themselves had a child, it seems to me is so unfair and indefensible. And we will argue about this, I am sure, for the next few months, but we are not disagreeing on what happens if someone refuses to work. What we are simply disagreeing on is how America's youngest and most vulnerable citizens ought to be treated by the Government of the United States and by the States.

Mr. KLECZKA. Thank you.

On another point, Dr. McDermott mentioned that there will be a migration of poverty from one State to another if in fact one State happens to be more generous than the other, and as we all know, poverty and pollution cannot be confined to a particular State or its boundaries.

We find in the State of Wisconsin, where I hail from, that our payment levels are somewhat higher, and we do serve in some respects as a magnet to recipients from Illinois and Texas and other parts of the country. So I say that with the knowledge that total States' rights will promote that, and also encourage my colleagues to look at some continued Federal role as far as benefit levels or some other programming to make sure that does not occur.

Last, Madam Chair, there are members of the panel who are working on an SSI reform for the SSI children's program, and although we do not have time today to discuss that, hopefully, we could possibly include some reform for the SSI kids' program in this welfare reform bill, and maybe you might have a thought on that.

Secretary SHALALA. Congressman Kleczka, let me make a comment on the last point, the last two points you made quickly.

One of the advantages of having national work requirements and some kind of a national framework is that it will do someone no good to try to go to another State in which there will be time limits, because they will have to fill the work requirement and they will not be able to add on 2 years because they went to another State.

Second, on the issue of SSI and children, in the independent Social Security bill, you and your colleagues asked me in January, this month, to appoint a commission to take a look at that program. I have done that and the chair of that commission will be former Congressman Jim Slattery of Kansas, who has agreed to chair that very important commission. They will report directly back to Congress. I think it is the end of November they are expected to report back.

Mr. KLECZKA. Well——

Mr. CRANE. The gentleman's time has expired.

Mr. KLECZKA. If I might finish with one comment, Mr. Chairman. That commission was part of the Social Security reorganization bill. The bill was also signed in August and we have waited from

August until now. I am fearful that there are members of the committee, including myself, who are going to want to move ahead on this issue prior to November. So maybe you can tell our former colleague, Jim, and the commission members to speed up their review.

Secretary SHALALA. They are going to come up and talk with you and they are well aware of the speed that is required.

There is also an internal review going on within the administration of the program.

Mr. CRANE. Mr. Houghton.

Mr. HOUGHTON. Secretary, good to see you. Thank you very much for being with us this morning.

Secretary SHALALA. You are welcome.

Mr. HOUGHTON. It still is this morning, isn't it?

I would like to revisit the job issue problem for a moment. Mr. Gephardt was here and he talked about four basic human standards, and one of them was creating jobs and opportunities. You have mentioned this in your testimony, a few simple goals, and the first is to move people off welfare and into jobs. And then you further expand on that when you talk about the possibility of their not being able to get jobs then to move into temporary subsidized jobs.

Seems to me this is really the key issue of this whole program, is to get people back to being well-serving, proud citizens of this country, but they have to have work. Many times those jobs are not available. So what will we do? What does the private sector do? What are these temporary jobs? Maybe you would like to expand on that for a moment.

Secretary SHALALA. The States can create the temporary jobs in any way they wish. They can provide a small subsidy to the private sector. They could get some private sector—some employers to volunteer to do some temporary jobs. It is really up to the State. The point is that what we are trying to do is to move people into permanent private-sector jobs and what we do not want to do is to overdevelop the public sector or put in someone's head that what they are going to be in is a subsidized public-sector job forever as opposed to that as a transition, given the economy of the community they happen to be in.

So I think we would like to stay very focused on private-sector jobs and on taking and staying in a private-sector job.

Mr. HOUGHTON. Thank you.

Mr. CRANE. Next, Mrs. Johnson.

Mrs. JOHNSON OF CONNECTICUT. Thank you, Mr. Chairman, and welcome Madam Secretary.

Secretary SHALALA. Thank you.

Mrs. JOHNSON OF CONNECTICUT. First of all, let me commend you on the number of waivers you have granted States. It has been exciting to watch and it has taken some courage to allow States to do some of the experimenting you are going to allow them to do, and I commend you on that.

I also commend you on this bill in lowering the participation age requirements. I tried hard in 1988 to get the right to bring to the floor an amendment that would have required young mothers when their first child was 1 year old to be subject to the work requirement and was denied the right to even bring it to the floor. So I am very pleased to see you looking to bring young people into the work program when their youngest child is 1 and when their second child is 12 weeks.

There is, however, some misunderstanding about the provisions in our bill that deny benefits to children who have children. It seems to me from your comments that you are not acknowledging or perhaps understanding the aspects of our legislation that will give States the same dollars that they used to spend on benefits for teenagers, teen mothers, but will free them to use those dollars in a way that I think will far better serve those teen parents.

I think it is unwise at this point in our history to treat children as adults simply because they have a child. And that is what the old mandate did. It mandated that the only way a State could respond to a teenager who had a baby was to give them an income.

What we are saying is, States, you get the same money. Now you can use it for very, very much better developmental day care, you can require teenagers to not only go to school but also to come back to the developmental day care center after school and participate in parenting education, or supervised study, or money management courses, or whatever. We will have resources now to much more aggressively address the career development, the personal development needs of these young mothers. And I think that has been the big failing of the system in the past.

So, far from looking at the repeal of the mandate to provide an income to kids under 18, who are not prepared to manage an income, much less a family, we are going to free those resources to pair with the parent. After all, the law requires if you have a child when you are under 18 you are responsible for him or her. So we are merely going to hold parents to their continued responsibility, their legal responsibility, and require States to provide services and to use the money to provide services to that group. I just wanted to clear that up.

I have two questions. One is, why do you oppose denying benefits to anyone applying for welfare who does not identify the father? Now, recognizing that there is a small, very narrow slice of a problem in this issue of paternity determination, putting enormous pressure on people to identify the father, given our ability to verify paternity, seems to me far more progressive public policy, both for men in America and for women in America, and for children. So I am interested in your thoughts of paternity determination.

And my second question concerns the lack in our bill of any prohibition on supplanting, on eliminating public-sector jobs. I do believe that it is wise at this point to use welfare benefits to pay wages for jobs that welfare recipients could easily do that local taxpayers are currently funding and that that old prohibition in the 1988 bill prohibiting supplanting public jobs was simply backward looking.

It will take some time, but through attrition we should be able to open up some jobs that welfare recipients can cycle through, so that they learn to get there on time, they learn to take supervision, they learn a lot of skills and then can move to the private sector.

So I think both of those "outside the dots" issues in paternity determination and in using welfare dollars to actually pay for real work and keeping those options available, a whole different approach to what we used to call public employment, are very constructive aspects of the Republican bill that are not being acknowledged for the potential that they have for us in the dialog that I think has to produce a really good welfare reform bill.

Secretary SHALALA. Let me say quickly on your first point, if the explanation is that those dollars are available to work with those teenage mothers in other sorts of ways, then why the need for a lifetime limit on those children never having access to public funds for any purpose?

Mrs. JOHNSON OF CONNECTICUT. The lifetime limit is only in the Contract bill. It is not in the bill that went through the Republican conference and not in the bill the Ways and Means Committee members introduced 2 years ago. That is an issue we will all talk about. The logic for the limit, of course, was to try to deal with the issue of people residing in public service jobs for a decade.

But Governors will have some ideas about that. We will all talk about that. But certainly in a number of major radical welfare reform bills proposed by Republicans, our interest is work.

Secretary SHALALA. Well, I am happy to hear that, and, obviously, you and I have agreed on a number of aspects of welfare before and I am sure that we will again. But it is a harsh program when you give a lifetime limit to a child because they were born to a teenage mother when they are off for 18 years from getting any kind of aid other than Medicaid and food stamps. So my point there is that we need to look at it.

On paternity, let me say I must have been misunderstood. My point was if the mother has identified the father, and, that is, she has done her part of the paternity establishment, she has done her part, then our view is she would be able to get aid for herself and for her child for the limited period of time of the program.

Mr. CRANE. The time——

Secretary SHALALA. Because the establishment of paternity, if the State does not do its part, why should she be harmed? She has done what she is expected to do. The State has certified she has provided the information.

Mrs. JOHNSON OF CONNECTICUT. Just to conclude, since our time——

Mr. CRANE. Time of the gentlelady has expired.

Mrs. JOHNSON OF CONNECTICUT. I would say current law does require that and we are not really forcing paternity determination and we have to be much tougher than that to find a way to do it.

Mr. CRANE. Mr. Lewis.

Mr. LEWIS. Thank you very much, Madam Secretary. Thank you for being here.

Like my colleagues from the State of Washington and from the State of Wisconsin, I am deeply troubled by this rush to embrace State rights. I think the welfare system must be uniform. You cannot have one system in New York and another system in Georgia. In another period of our history we had a great migration in our country from one region to another region, for many reasons, but one was because of welfare benefits.

The Federal Government has played the role of a sympathetic referee. Could you explain, elaborate, how we are going to avoid one part of the country receiving better benefits?

Secretary SHALALA. Well, I think that the proposal that we have put before this committee last year tries to establish, to find a balance in this Federal-State partnership. It tries to establish minimum benefits to protect children, which, after all, is the fundamental point here. And, second, tries to raise the bar and have expectations for parents.

So it tries to change the current welfare system for everyone from one end of the country to the other. So the focus is on a transitional system, on work, and on the responsibility of parents for supporting their children.

So I think that, Congressman Lewis, what we are trying to attempt here is a framework in which we all agree that work ought to be the purpose of transitional help for our citizens; that children ought to be the responsibility of both parents, not simply of the government, and we must do everything we can to help citizens move into work so that they can support and provide for their families. And that that requires some minimal national standards. What we do not want to do is establish a program in which because you are born in Georgia you might go to bed hungry, and if you are born in Wisconsin, the State is more generous in terms of the kinds of benefits it provides.

So there is a national interest in a small number of things. We have established it for the elderly, to make certain that we lift people out of poverty, and I believe that this country has long had a commitment to children. How we do that and how we maintain the kind of flexibility that the Governors very much want and need but, at the same time, have a floor and a flexible floor that responds to different kinds of economic situations State by State, which is very important, because many of those people who come on are workers who need temporary help, is what this debate is really all about.

Mr. LEWIS. Madam Secretary, let me move to another question. The new Speaker spoke a great deal about preparing our children, I guess last week, last Wednesday, preparing our children for the 21st century.

The Republican Contract With America will reduce funding for the Federal nutrition program, including the school lunch program, by $11 billion over the next 5 years. I do not understand how reducing school lunch programs will help our children prepare for the future. When they are hungry, they cannot learn. I do not understand how poorly educated children will help business create jobs in America.

Do you believe that the Republican proposal to cut nutrition programs is consistent with the Speaker's statement about supporting children?

Secretary SHALALA. I believe that the food safety—that eliminating or substantially reducing the food safety net that has been put in place in this country in a bipartisan manner and supported over the years, that it would be a national tragedy. That fundamental to learning, to working, to being able to live to get to the 21st century is proper nutrition. And we have long, as a Congress and as a Nation, supported providing fundamental nutrition programs to our citizens.

I sat in a food stamp office in a Southern State a number of years ago when there was an economic downturn, where working parents came in for food stamps, ashamed and embarrassed but wanting very much to do the best for their families, at least until they found another job, and these programs are not simply for people that are a part of a long-term dependency that we need to break, but they are also for short-term needs as there are economic downturns in different parts of the country. There is no way to write a formula that will solve that problem.

There have to be some fundamentals here of what we believe as a country and what defines us and one of them ought to be that children ought not to go hungry, that adults ought not to go hungry when they are willing to work, and when they want to do the best for their families.

Mr. CRANE. The time of the gentleman has expired.

Mr. LEWIS. Thank you, Madam Secretary. Thank you, Mr. Chairman.

Mr. CRANE. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

Madam Secretary, certainly the issue of welfare reform is a very complex one and involves much more than AFDC or food stamps, but we appreciate your coming before us today and sharing with us your thoughts on the issue and we look forward to working with you and the administration in trying to solve some of the problems that we have in our welfare system.

Let me ask you, though, your estimate of children to be deprived of AFDC benefits has changed, I think, in the last couple of weeks. What is it now that you are estimating the number of children that would be thrown off, as you say, welfare when you really mean AFDC, I think? According to the Contract proposal.

Secretary SHALALA. If the States adopt the least restrictive option available to them, 1.3 million would lose their eligibility for AFDC after the first year of implementation.

Mr. MCCRERY. On what methodology is that figure based?

Secretary SHALALA. It is based on an analysis of the bill that was submitted.

Mr. MCCRERY. I am sure it is. But what was the methodology that was used to reach that figure?

Secretary SHALALA. We assumed that the States would adopt the least restrictive options, which would include denying benefits to children born to mothers under 18, denying benefits to children of AFDC applicants who do not establish paternity for those children, and denying benefits to children conceived or born after their parents received AFDC.

So we took three of the major elements of the plan and worked our way through those numbers.

Mr. MCCRERY. Let me see if I can be more precise in my question. Since this is a prospective provision, and since none of those children have been born, how did you reach the figure of 1.3 million? Did you just reach in the air and pull that down or——?

Secretary SHALALA. No. We calculated—we know what the trend line is of children born to mothers under 18, obviously. We know something about a paternity establishment in the States and how effective the current State systems are. And since there was not child support enforcement, though there obviously is going to be as part of this, we made a calculation based on that. And we also know something about children born while their parents are on AFDC, so we made a calculation based on that. So we based it on behavior and on the trend lines of behavior, and these are the least restrictive options.

I would be happy to provide this to you in some detail showing you what our assumptions were, but we used 1993 data.

Mr. McCRERY. OK. I would be interested in receiving from you the methodology that you used.

Secretary SHALALA. Be happy to.

[The following was subsequently received:]

The Department of Health and Human Services estimates that the welfare proposal will deny AFDC to 1.3 million children one year after implementation. This analysis assumes the following provisions within the proposal are in place:

- deny AFDC to children born to unmarried mothers under 18
- deny AFDC to non-exempt non-citizens
- deny AFDC to children conceived or born after the AFDC case began
- deny AFDC to children without paternity establishment
- deny AFDC to minor mothers not living with related adults.

The mandatory five year time limit on AFDC receipt (2 years at state option) has no effect one year after implementation.

The Department's estimate is based on data from the 1993 Quality Control file (QC) and generated via the AFDC-QC microsimulation model. Data from the QC file were collected during fiscal year 1993 and includes demographic characteristics and average monthly income amounts for the month in which the case was reviewed for the sample. Characteristics used in the analysis included age of mother, age of children, reason for eligibility (i.e. parents unmarried) and immigration status. The full AFDC-QC dataset contains roughly 54,000 unweighted households. Each observation is a "snapshot" of the sampled unit in a particular month. The results of the AFDC-QC model simulations represent effects on AFDC caseload in the "average month" of the fiscal year.

The Department's estimate represents the combined affect of each provision of the proposal as if 1993 was one year after implementation. The AFDC-QC microsimulation model tabulates the number of children affected by each provision. The model applies the rules of the AFDC program - both actual and proposed - and applies them to each AFDC unit in the QC sample. The effects of the proposal are determined by comparing the results generated by the modified AFDC program to the results simulated under the actual rules.

The estimate assumes no change in behavior. For example, no reduction in teenage fertility, no increase in teenage marriage, etc.. The estimate above also assumes that states do not take the more restrictive options such as two year time limits and denying AFDC to children born to unmarried mothers 18-20 years of age.

Summary Revenue Table
(Numbers in Billions)

Revenue Provisions	Administration's Original Estimates
Emergency Assistance	1.6
Immigrants	3.8
DA and A	0.8
Farm Income	0.5
EITC	0.3
Superfund	1.5
Day Care Homes	0.5
Other Expiring Provisions	0.3
TOTAL	**9.3**

Secretary SHALALA. Could I say something about your first comment, because I think it is important that I set a tone here?

Mr. MCCRERY. Sure.

Secretary SHALALA. And that is that this is hard to do. We are all so glib. We can have our fun with the orphanages issue, and I appreciate the fact that you want to make sure that everybody has orphanages in their plans. But this is hard to do. It is hard to move people. Every single one of those States that we granted waivers to, every single one of those Governors—doesn't make a difference whether they are a Republican, a Democrat, a Liberal, or a Conservative—will tell you it is very difficult to break long-term dependency, to move people into jobs.

So we can debate about whether our plan moves people quickly enough. We can look at the literature. But what every experiment that we have approved, and we do not have finals, obviously, on these, what every Governor and every county official, what every welfare worker and recipient has told us is this is tough to do and that we should not——

Mr. MCCRERY. I agree, and, as I said, we are looking forward to working with the administration to try to solve the problems.

But let me get back to the methodology for just a moment. Did you in your methodology assume a change in behavior due to the change in public policy?

Secretary SHALALA. We did not——

Mr. MCCRERY. Or did you take numbers from 1993 and move them forward into 1995 or 1996?

Secretary SHALALA. I think what we did was simply assumed that the first year there would not be a major change in behavior. But even if we assumed a 50-percent change in——

Mr. MCCRERY. What about the second year? Did you assume a change in behavior in the second year?

Secretary SHALALA. I don't think we did. I don't think we did, but——

Mr. MCCRERY. And on the third year?

Secretary SHALALA [continuing]. But let me say——

Mr. MCCRERY. My question, Madam Secretary. How about the third year? Did you assume any change in behavior?

Secretary SHALALA. No, and I have not given you numbers for the third year. I have given you numbers only for the first year.

Mr. MCCRERY. My point, Madam Secretary, is I am afraid we may have a basic disagreement. Throughout your testimony you keep going back to government as the answer. If people cannot get a job, we will give them a public job. And we are not going to restrict the time they are on that public job. If people cannot have any personal responsibility and take care of themselves or not have a baby when they are not economically able to care for that baby, fine, we will take care of them.

I think maybe that is a basic disagreement that the majority has with the minority and perhaps with the administration. That remains to be seen. But we think that if you make very powerful changes in public policy, then you will drive, to some extent, more responsible behavior in our society, and that may, just may, affect the numbers that you have given us. So I think—and I am anxious to see the methodology.

Maybe I am wrong, but I suspect you used what we might call a static model of projecting the numbers of children who would be deprived of AFDC in your analysis. And if that is the case, then I think it is a faulty methodology.

We think public policy changes can affect behavior in this country. That is what the welfare reform debate, I think, should be all about: What public policy changes can we make to positively affect behavior in this country, because we think public policy for the last 30 years has affected behavior negatively.

Mr. CRANE. The time of the gentleman has expired.

Secretary SHALALA. Mr. McCrery, we have no disagreement on the power of what is very strong reform changes in the President's bill as well as in the other bills. The issue for us is to what extent we wish to punish innocent children as part of the process of changing——

Mr. MCCRERY. Madam Secretary, the current system is punishing innocent children every day. If you deny that, you are missing the point.

Mr. CRANE. Time of the gentleman has expired.

Secretary SHALALA. Congressman, we are in this bill's business because we want to change and provide opportunity for innocent children. That is exactly why we are both in this business. And all of us use powerful incentives, and all we are saying is that there is a point at which that perhaps the proposals are too punitive, where we can achieve the same result without being overly punitive.

Mr. MCCRERY. And I agree with that, Madam Secretary, and we look forward to working with you to make sure that occurs.

Secretary SHALALA. Fair enough.

Mr. CRANE. Mr. Gibbons.

Mr. GIBBONS. Madam Secretary, you have done a great job during your 2-year tenure here, and you have done a great job this morning testifying and working in a very factual manner.

I think one of the most important provisions of any child welfare bill that we develop here is parental responsibility, not only for those who qualify for welfare but those who are just above the poverty line.

There has been a great neglect, mainly, I regret to say, on the part of fathers of their offspring. And what I want you to do for me right now is to outline what the responsibility is of the father, whether the child was born in or out of wedlock, will be under the new legislation, as you see it developed, versus the status quo today.

Secretary SHALALA. Well, we have basically—the father will be expected, under the new proposal, to provide financial support for their child. That is an uneven process today in this country. It will be uniform under the President's proposal. Whether or not they are the custodial parent, whether or not they are living with the mother and with the children.

Mr. GIBBONS. Whether or not the child was born in or out of wedlock?

Secretary SHALALA. Whether or not the child was born in or out of wedlock. We will establish paternity and expect the other parent to take responsibility for helping to provide support for that child.

Mr. GIBBONS. Whether or not the child is a welfare recipient or a nonwelfare recipient?

Secretary SHALALA. Whether or not the child is a welfare recipient, or whether or not the child was born out of wedlock, we will expect both parents to take responsibility for supporting that child.

Mr. GIBBONS. Now, how are we going to do that in the future versus the way we do it now?

Secretary SHALALA. By putting in place a very strong child support enforcement system that begins with the establishment of paternity. And in the process that we had outlined last year for the committee, the mother identifies the parent—the father—and the State has 1 year to legally establish paternity. The child support enforcement system kicks in.

Nationally, every State will have a system in which they will be expected to follow up. It will be an administrative procedure as opposed to clogging up the courts, with regular updates, and there will be sharing of information between States.

As you know, one of the problems now is that a father escapes to another—I am trying to be careful about the language, there are some mothers involved, too.

Mr. GIBBONS. I understand.

Secretary SHALALA [continuing]. And where a father leaves the State and will want to follow up. We will use W–2 forms. We will use sanctions. The State of Maine this year, last year, wrote a letter to every father who had not paid their child support and said, what is at risk now is your driver's license, your professional license, and people came trotting in very quickly to start paying their child support payments. So it is not only access to wages and perhaps to property, but also to licenses. And the States will be able to use these tools to collect child support.

The updating is almost as important, Congressman Gibbons, as anything else because there are child support orders out there, but often they are not updated and the mother does not have the wherewithal to go back into court to do that.

Mr. GIBBONS. I understand that. Answer this question, if you can, please, ma'am. It is very frustrating now to go across State lines and enforce an order. How would that be improved?

Secretary SHALALA. There are a number of recommendations that have been made for approving that, including putting a national system in place. The Interstate Commission made some recommendations that would allow one State to pass the information on and make the collection and allow a national information system to kick in as part of this. And this will make it very easy to move from one State to another to collect child support enforcement.

There will be a national clearinghouse. We will use national W–4 reporting as a way of identifying parents.

Mr. GIBBONS. Let me tell you, one of my practical experiences in trying to enforce these types of orders has been that once the responsible person goes to another State, the other State takes very little interest in the mutual support. It drags on and drags on until finally the family has to abandon any real hope that they can ever get help. And I think that child support enforcement is one of the most important things we can do here. Our interstate enforcement is, frankly, not good and we need to improve that substantially.

Secretary SHALALA. Right.

Mr. CRANE. Time of the gentleman has expired. Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman. Madam Secretary, I would like to join my colleagues in welcoming you to this meeting.

As you recall, we spoke very briefly at the White House over the Christmas holidays and were talking about how we were going to move this forward and wanted to work in a bipartisan way, and I certainly would want to repeat that today, because I think it is important to emphasize the similarities between the administration's bill and the various Republican bills, including the Contract With America bill, which, in itself, I think has the same philosophical underpinnings. I think they both recognize that the present system we have is going the wrong way. It encourages illegitimacy, it discourages marrying, and it discourages work.

My criticism of the administration's bill, I have a number of them, but the main criticism is it did not go far enough. I was interested in the answer you gave to Mr. Archer in response to his question on who was covered under that bill and the percentages. And if I recall correctly, you said one-third was included in the first year, and after 5 years it went up to 50 percent.

As I recall, and I have not looked at the administration's bill in a number of months, but as I recall in the administration's bill, after 5 years, there was a dispute as to whether it covered 190,000 or a quarter of a million people, but because of an age cutoff it only applied to the younger people and did not attempt to apply to the mothers who were born before 1975, and that it was almost anemic in the coverage that it gave.

Could you review those figures with us again?

Secretary SHALALA. Yes. Let me explain, first, the phasing in strategy that we used in the bill, though. I think one of the things we want to make very clear is that in that bill, while we suggested we start with the younger people, the States had the flexibility of taking on a much higher percentage of their population if they were prepared to do that, and that was, in fact, part of the proposal.

The reason that we put together a bill that in fact phased in over time is the answer that I really gave earlier; that it is very expensive to put the program together.

Mr. SHAW. I understand that, if I could reclaim my time.

Secretary SHALALA. Because the Governors themselves indicated they would have to phase in. It is a function of resources and the willingness of the Governors to move much more quickly.

Mr. SHAW. Oh, I am very aware of that.

Let me—it is my time, Madam Secretary, and I am going to have to insist that you answer the question. Does it cover 50 percent of the population after 5 years, of the welfare population?

Secretary SHALALA. Yes, it did, it covers 50 percent of the targeted, phased-in population.

Mr. SHAW. I will be very, very interested to review those figures. Does it cover more than a quarter of a million people?

Secretary SHALALA. Our numbers indicate that we phased in one-third right away and got to 50 percent after 5 years and everybody was phased in eventually.

Mr. SHAW. This is of the total AFDC population?

Secretary SHALALA. This is of the total AFDC population. But, remember, the difference between our bill and what is in the Contract is that there were some exemptions in our bill.

Mr. SHAW. Fifty percent of the total AFDC population would be 2.5 million, Madam Secretary,. You must reexamine your figures because you do not cover that.

Let me go to another point.

Secretary SHALALA. OK, 2.3—let me read you the—let me read you the numbers. Remember that when we are talking about phasing in, you are using the number of jobs and we are talking about people that are parenting in the mandatory training in the education placement programs, and so we are counting the whole number as we are moving through.

In 1997, we are assuming that there were 1.6 million adult cases with a parent born after 1971. Two hundred eleven—I can give you the chart—211,000 would be working or off welfare; 904,000 would be in time-limited mandatory training, educational placement programs with strict participation standards; and about 500,000 were deferred or exempted by the States due to a disability; they were caring for a disabled child or an infant or some other exemption the State gave them.

Mr. SHAW. Let me begin by expressing disappointment in your statement in which you said attempting to implement welfare reform without strengthening child support enforcement sends the wrong message. It says the noncustodial parent is not one-half responsible for the birth. Your statement indicates that the Republicans have not addressed that issue.

I can assure you, Madam Secretary, we did not require paternity establishment in order to advise the father he can hand out cigars.

I might also say I was very disappointed that you chastised the Republicans in that bill when the Republicans have been talking to the ladies and gentlemen right behind you. We said that we wanted to move forward with a separate bill in a bipartisan manner to address that issue. That issue is of prime importance. Paternal responsibility is something that this country has to come down on with a hard foot. We are going to proceed with that. Madam Secretary, you know that, your staff knows that, and I would hope that we can put this aside and move forward on that as a separate bill. That is tremendously important and it is one that this Member, as chairman of the Human Resources Subcommittee, plans to make of prime importance.

You heard from Chairman Archer. Now you have heard from me. We are going to do it, and we would like to do it in cooperation with the administration.

Chairman ARCHER. The gentleman's time——

Secretary SHALALA. We would, obviously, love to cooperate, Mr. Shaw.

Chairman ARCHER. Gentleman's time has expired. The Chair recognizes Mr. Hancock to inquire.

Mr. HANCOCK. Well, thank you, Mr. Chairman.

I just wanted to get back and follow up a little bit on Mr. McCrery's comments about the static and the dynamic model. I mentioned it earlier when Mr. Gephardt was testifying. I think that is something that we fail to look at; we consistently fail to look at it.

You have been testifying for about 1 hour and 50 minutes now. I appreciate your coming by, and thank you very much for the information, but, seriously, let's look at the impact of the changes that we make on the dynamics of a dynamic country where people do have the opportunity to solve their own problems rather than to ask us to sit here in the U.S. Congress and solve the problems for them. Thank you.

Secretary SHALALA. You are welcome.

Congressman, I would love to make very strong assumptions about behavioral changes that will occur once the bill gets put together. We obviously all agree that it must be a very strong bill. The President is committed to a very strong bill that does change the behavior of the welfare system but, in particular, that provides opportunities for people to move quickly off of welfare and to take their responsible places as taxpayers.

The fact that we did not assume these changes in the first years of our projections, I have stated very clearly that we did not, and been honest about that, even if we assume 50-percent change we would still have large numbers of people who—large numbers of children who did not have access to cash payments, to be very clear, and we simply disagree on that. But we have a lot of work to do together, and I look forward to working with you.

Chairman ARCHER. Mr. Rangel will inquire.

Mr. RANGEL. Madam Secretary, it is always good to see you, and I am going to need a lot of help from the administration in order to work out something with my friend, Chairman Clay Shaw.

The emphasis now is on a very unpopular subject, that is, people who are receiving government checks. All of America, and probably they wish that they were working.

You mentioned that 70 to 90 percent of AFDC mothers are off welfare between 3 to 5 years. I need your staff to sit with me to find out the profile of these people that we are talking about. The problem, as I see it is children who are raised in communities where most of them do not get out of high school with a certificate and those that do do not have jobs or job opportunities, the future really does not hold much for them, whether they are male or female. That is why the males more often than not have no alternative to getting involved with drugs and crime and violence, and they end up in jail. And you can have death penalties and mandatory sentences, but you still see that flow coming.

Now, take the girls. When I was a kid, girls didn't have sex because they were afraid of getting pregnant. They were hoping to get married. They wanted to be considered decent, and not have jobs but at least marry someone who was working. I see generations of young women having kids so that we now have welfare grandmothers that are less than 40 years old. And everyone says, well, they should be working.

Why can't we get some help from the Secretary of Labor? Why is it that we are saying that we should have training and they should have jobs, and if they do not, this is what is going to happen?

We do need people with certain skills in this country. I go into any hospital, veterans', private, public hospitals, and the nurses are coming from Ireland, the Caribbean, the Philippines. It just seems to me that somewhere along the line, whether you are a welfare recipient or not, someone should say, this is what your country needs, we are going to train you, you are going to have pride, you are going to enjoy it, and you are going to work.

We talk about day care. My God, there has to be a need for people to be trained in taking care of other people's kids.

Libraries, to me, you do not even have to subsidize it.

You have to invest in the training, not just to punish children and mothers but to prevent people from believing that there is a better life having a kid and being on welfare, which is a terrible life.

Can't we get the Secretary of Labor to identify for my Chairman the jobs that we are going to need in the future. Not just for welfare recipients, but for those who live in communities that foster dependency, whether dependency with a warden or dependency with a socialworker, and that way we would know the job is there rather than saying that we will not take care of your kid if you are not working.

Can we get a team? Because I am convinced that Clay Shaw is the type of sensitive person that if he knows there is no job, and if he knows there is no training, that just cutting off somebody is not going to deter the problem that we face today. Can we get a team besides your office to identify who we are dealing with? Because it seems as though this person has got a lot of problems other than just having a baby.

And the second thing is to identify the needs of a community and to lock that up with making certain that there is a job to be had. Can that be done?

Secretary SHALALA. Certainly, Mr. Rangel. And I have a feeling you and Mr. Shaw are going to work very well together.

We had agreed as part of the President's proposal that we would use the Department of Labor's JOBS programs, that the Governor would be able to have access to the one-stop shopping and the streamlining of the JOBS programs that is taking place. And I know both you and Mr. Shaw have been long supporters of streamlining this so it is an easier process to use and so that we do not duplicate these services as part of our overall effort.

Second, your point about generations is very important. I spent the weekend rereading the literature on teenage pregnancy, and what struck me was that all of us are using the language about the kind of rules that we have to lay out for these young people—they have to live with their families—when what is really happening is, in part, they obviously have to take responsibility for their behavior, but they are getting very ambiguous messages from the adults around them. It is not just the media and those of us in public life, but it is the mother—it is the young girl that said to me, if I have a baby, my mom and my grandmother said she would help me, they would help me bring it up. It is the messages and it is not just low-income communities, it is middle-income communities, too.

We need to send a clearer and more deliberate message about teenage sexual activity, period, let alone the next piece, which is pregnancy. And the adults need to do it. This business about responsibility is not only about teenagers, but it is also about the adults in society and the way in which we organize ourselves and send young people messages. It may be peers. It is remarkable how the literature reflects on older siblings and their own sexual activity and their own messages on kids that they go to high school with or junior high in many cases, which is of course tragic.

So we have a lot of work to do in this area, and I look forward to working with you and the Chairman and Chairman Shaw and Mr. Gibbons.

Chairman ARCHER. The gentleman's time has expired. Mr. Ramstad will inquire.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Madam Secretary, coming from your neighboring State, it is always good to see you. And I know the hour is waning, and I will be brief. I have but one question.

I truly hope that we can take off, to the maximum extent possible, our Republican hats and our Democrat hats and work in a bipartisan, pragmatic way to radically reform the welfare mess in America. I am encouraged when you say that your overriding objective is to break the cycle of long-term dependency, and I think that is ours as well on this side of the aisle.

And I know that you agree because I have heard you say it before that the astronomical increase in teenage girls having babies is a devastating social crisis in America that we must deal with. But what I don't understand is, absent the sanctions in our Contract With America, how in the world can we reverse this alarming trend in teenage girls having babies? I mean, if there aren't any sanctions such as we propose, how are we going to address the problem?

Secretary SHALALA. I think that 90 percent of the sanctions or what I considered the nurturing responsibilities we agree on. Mr. Shaw and I agree that teenagers ought to live in their families. They ought not to move out and set up a separate household. We agree that these teenagers ought to finish school as part of the requirements of getting any kind of aid. We agree that they must establish paternity as part of that requirement. We agree that they have to get additional training and get ready to go to work as soon as they finish high school.

So those parts, the central parts of what our expectations are for young people, in addition to all of the earlier things that go on—a long-term strategy for teenage pregnancy prevention that involves communities organizing for abstinence and to reduce the number of young people that are engaging in sexual activities—all of those things we agree on.

We agree on the work requirements. We agree that there ought to be some kind of a time limit. Where we are having this disagreement is about whether there ought to be cash payments, whether there ought to be some money provided for the child.

My suggestion—I have enormous confidence in the good sense and the great experience of Chairman Shaw, and I just think that we can work through this together. That is why I am here. I think we are very close on a number of these issues, and we just have to work through this and not harden our positions. And that is what we are prepared to do, and I simply look forward to the opportunity to work with all of you.

Mr. RAMSTAD. Thank you, Madam Secretary. I am very encouraged by your conciliatory tone as well as the areas of consensus you identified.

Thank you, Mr. Chairman.

Secretary SHALALA. If I don't get a smile out of Mr. Shaw before I leave here, I am in big trouble, Mr. Chairman.

Chairman ARCHER. Mr. Stark will inquire.

Secretary SHALALA. Oh, this will be tough.

Mr. STARK. Thank you, Mr. Chairman.

I have heard some reference to abstinence, which has never been very popular in the 13th Congressional District in California, and I have never chosen to run on that platform, but if that is what Mr. Shaw wants to sponsor, I suppose I could go along with it.

I am concerned, though, that we, with a great deal of delight and hard work and support from the Secretary and the administration last year, passed the Family Preservation Act, and principal to that was that at all costs, absent abuse of the child, that the child should be retained in a situation with a parent.

Now I am getting mixed signals, and I must say I have heard questions on the Contract and on the President's plan, and I am reminded of what Tip O'Neill would have told you. He would tell you that those Republicans are just trying to cut welfare off at the hips, and you are trying to cut it off at the knees. I don't know if you choose not to punish innocent children, how turning a child over to the welfare system because the child's mother is unable to find a job can qualify as anything but punishing innocent children.

Now, you criticize President Reagan's Family Support Act for exempting women with children under 3 and mothers under 16—I presume that is so they could be in school—and pregnant women in their second trimester. I happen to think that those exemptions are quite worthwhile. And you then proceed to say, well, in Indiana you are going to let them punish children if a woman on AFDC has a second child without regard to how old that mother is.

So on the one hand I am hearing that in Indiana it is OK to kick them off AFDC and punish the innocent child, but it was wrong for President Reagan to do it. And I must say that it is going to be very difficult to convince me that we are not going to punish innocent children if that is what I read all the way through your testimony.

I am tremendously concerned by the fact that we are abandoning what we passed which I thought was good legislation and—in our haste to show who can be the toughest and the nastiest to children, beating up all over them. I would hope that the Democratic Party would begin to distinguish itself.

I think Mr. Shaw is going to go along with me before we are done and say that it is absolutely unacceptable to punish innocent children. If it is done through a waiver, it would be much simpler. Clay and I wouldn't have anything to do if we would just grant all 50 States a waiver. Then we have a block grant and all the kids could get kicked off AFDC, and we don't have to go through all these long hearings and markups. We can beat Gingrich to the punch. We could get those waivers done in 30 days. Then we don't have to wait for 100 days.

So I hope that either we are going to define the Democratic policy with more distinction and not in matters of degree, or we are going to sit down and work out a compromise with Mr. Shaw. I would be willing to start at the point where Mr. Shaw will guarantee me that we are not going to punish innocent children. And I include punishment as dumping them into the welfare system. So I would like us to see from our side of the aisle where we are going to fight, and if we aren't, let's get to work and see that we protect the children.

Thank you for being with us today.

Secretary SHALALA. Congressman Stark, I have been very clear about the President's proposal, and that is, the President's proposal does not remove an adult from the welfare system who is willing to work, who is willing to go through the training program.

Mr. STARK. It does in Indiana under the waiver you just granted.

Secretary SHALALA. The Indiana waiver—if you are talking about the family cap——

Mr. STARK. I am.

Secretary SHALALA. It is true that we have allowed some family caps, and the President's proposal allows some family caps depending on what a State wants to do. It is also true that it is the States that set the benefit level, and we see the family cap within the context of setting the benefit level. A State could increase the benefit level and have a family cap for an extra, if someone had a child while they were on welfare.

But in the basic proposal that we have put forward, only if a parent absolutely—an able-bodied parent absolutely refused to go to work, to be part of a training program, to look for a job, would they suffer some sanctions. All I have said is then the child welfare system has to kick in and take a look at whether that parent is properly caring for that child.

But we have been firm on those who are looking for work. If they can't find work, then we need to provide a subsidized work opportunity on a temporary basis until they can find a permanent job.

Chairman ARCHER. The gentleman's time has expired. Mr. Zimmer will inquire.

Mr. ZIMMER. Thank you, Mr. Chairman.

Madam Secretary, I would like to commend you for the conciliatory tone that you have taken today and your expressed interest in reaching an accommodation with Mr. Shaw and other leaders of the majority. It certainly is in contrast to what I considered to be the harsh and confrontational and misleading aspect of your recent press conference on the Contract With America's welfare proposal, and I think it is a step in the right direction.

I would like to clarify a point that you made earlier. You said that in 5 years 50 percent of the welfare population would be covered by the administration program and eventually 100 percent would be covered. When does that eventually occur?

Secretary SHALALA. I don't know whether we costed out the whole program. What we did in our welfare proposal is to get started with the younger recipients and to phase them in beginning in 1997.

And once you go beyond the 3-year period—I mean, one of the discussions we are having here is when does behavior start to change as part of this proposal and is this proposal going to, in fact, change behavior in relationship to teenage pregnancy or anything else. So I don't have a set of figures in front of me that phases this in, assuming that there is no change in behavior over a long period of time, but I would be happy to give you our short-term numbers.

Mr. ZIMMER. So you—well, let's assume that behavior doesn't change because I think you were making that assumption.

Secretary SHALALA. Only for the first year.

Mr. ZIMMER. Well, could you give me two assumptions, one if it is static and one dynamic?

Secretary SHALALA. I do not have that on the President's plan. All I did was answer a question about the Contract plan, and that is what the impact would be in the first year if no other changes took place.

Mr. ZIMMER. Now, as I understand it, the phase-in is dictated as much by budget considerations as by any other considerations.

Secretary SHALALA. And, well, capacity. The phase-in discussion in the President's plan was in part a discussion with the Governors about how much they wanted to take on and how much their capacity to take it on. Some Governors said they wanted to take their whole system on. And our budget allowed—assumed that some of the Governors would take on their total numbers, and some of the Governors wanted to take on a piece. We suggested they start with the younger people. That is where we had some disagreements.

All I am saying about that is that it seems to me that that is an area where we all ought to be flexible.

Mr. ZIMMER. Do you have a plan for getting from 50 to 100 percent and a timetable?

Secretary SHALALA. I am sure that we have—the plan is to get to 100 percent. Once you get beyond——

Mr. ZIMMER. That is an objective.

Secretary SHALALA. Yes, we have an objective. The objective of the overall proposal by the President is obvious: To halve the entire welfare population and to reduce the number of people that are coming in. I mean, that is the purpose of everything we have said about teenage pregnancy prevention, for example, is start to reduce the actual numbers.

I will provide you with all the numbers that we do have, but, again, once you get out, after a certain number of years, beyond the first couple of years, then you have to start thinking about whether you want to build in some assumptions, and that is the kind of thing where the committee and the administration—where the Democrats and the Republicans and the administration ought to sit and talk about what kind of assumptions we are going to build into the long-term plan.

Mr. ZIMMER. You have said that for the first 3 or 5 years the program is designed to be revenue neutral. It is revenue neutral I guess in part because you are phasing it in so slowly.

Secretary SHALALA. Well, it is a $10 billion program.

Mr. ZIMMER. $10 billion in additional expenditures?

Secretary SHALALA. No, it is $10 billion. It is not new expenditures. It is $10 billion that is budget neutral. We have identified——

Mr. ZIMMER. Reprogrammed funds from the Department of Labor.

Secretary SHALALA. For the purposes of setting it up we have identified sources of revenue to pay for the bill when we sent it up last year.

Mr. ZIMMER. Do you have a plan or a timetable for assuring that it is going to be revenue neutral or I would hope ultimately to the benefit of the taxpayers when it is 100 percent in force?

Secretary SHALALA. We would—when we submitted the bill at the beginning we submitted the budget for a period of time, and I think that none of us have projected what is the impact of the teenage pregnancy pieces 5 years out and whether the numbers start to go down.

It is the kind of thing that I would not want to get into an argument with, rather sit down with the committee and work through and see if we could agree on the assumptions. We would have to do it based on some research we have.

We do have some research now that the States have been out, and we ought to have information about what is happening in the States that are trying these various kinds of changes. Some of the States are 2 years in. Some of them are 1 year in. So I think it is important that we bring what the experience out there is to bear on what our joint assumptions are about a change of behavior.

Chairman ARCHER. The gentleman's time has expired.

Mr. ZIMMER. Thank you.

Chairman ARCHER. Mr. Jacobs will inquire.

Mr. JACOBS. Mr. Chairman, I will follow the excellent example of Mr. Gibbons and yield my time to some other member.

Chairman ARCHER. Well, if the gentleman has no one in particular to yield to, the Chair will follow the orderly procedure.

Mr. JACOBS. I mean, I will make room for another member. I will let people go to lunch. How is that? Let the record show?

Chairman ARCHER. The Chair recognizes the gentleman from Georgia, Mr. Collins, to inquire.

Mr. COLLINS. Thank you, Mr. Chairman, and thank you, Madam Secretary. You have been very patient.

I want to refer back to the comments of the gentleman from New York. He mentioned a lot about jobs. I have asked this question several times. When we talk about moving people from welfare to the jobs, what jobs? He had a very good point there.

We must create more and more jobs in this country. And in order to do that, in accordance with Mr. Gephardt's statements, we have to have tax reform. So I am pleased to hear that Mr. Gephardt is very interested in reforming the alternative minimum tax which is a disincentive for the capital investment that creates jobs.

Another issue I would like to raise is parental responsibility. We have discussed children having children, and we have also discussed the denial of cash benefits or cash payments for those children of children, but yet we all agree that we are going to leave in place programs such as food stamps and health care and housing. The purpose of parental responsibility is not just to the parent of the child, of the teenager who had the child, it is also to the parents of the teenager who had the child, to insure that they understand if their child has a child then they have some parental responsibility. Requiring responsibility may lead to a change in behavior such as abstinence.

But I want to move to the other end of the spectrum, and that is to our seniors. We have a lot of seniors who need assistance such as in the area of long-term care.

You mentioned waivers, and I do know that there are some States who have requested waivers so that whereby Medicaid funds can be used for long-term care in areas other than institutionalized care, such as nursing homes. Does the administration have any position on making that a national effort to encourage States to move away from complete institutionalizing of seniors in nursing homes and allowing or requiring States to use those funds in other areas that are less costly than nursing care?

Secretary SHALALA. As part of health care reform we did make a recommendation that would allow States much more flexibility on moving to home care, day care for the frail elderly, ways of avoiding—helping. And there are some tax credit recommendations within the Contract helping families to keep their loved ones at home and making sure that families have choices other than institutionalization. We have a number of national demonstrations going on now looking for alternatives and trying to price alternatives.

I think all of us are enthusiastic about opportunities for more home care so that we can keep our loved ones at home as long as we possibly can. So I think all that flexibility has been very much a part of our discussion and the recommendations that we have sent up here.

I think the Contract has some things that are interesting that would help in terms of long-term care, and I hope, Congressman Collins and Chairman Archer, that we get a chance at some point to talk about, not today, but to talk about some of the things that we need to do in terms of long-term care that may be a combination of tax credits and some State grants and some more flexibility under the Medicaid program.

Mr. COLLINS. Well, we are now waiting for the States to request the waiver to use Medicaid funds for personal home care versus nursing home care. Should we not encourage States to use those funds for personal home care versus nursing home care where the cost is one-third of nursing care?

Secretary SHALALA. The answer is, are we prepared to move into a much more flexible framework with the Medicaid program? And I think that the answer is yes. And, in fact, there are all sorts of revolutions going on in the Medicaid program today that have to do with the movement to managed care as well as to trying to find a way around institutional care.

What has scared people away on home care is——

Mr. COLLINS. I said personal home care, which is not——

Secretary SHALALA. Personal home care, which I think is a combination of the States' right to have to supervise it, establish standards—and there are many States that are deeply involved in the home care business that already provide their own resources for home care as part of their own health package. What you are suggesting is are there more things that the Medicaid program could do itself. I am sure that there are, and I would be happy to sit down with you and discuss some of those options that are being explored now.

Chairman ARCHER. The gentleman's time has expired.

Mr. COLLINS. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Matsui will inquire.

Mr. MATSUI. Thank you, Mr. Chairman.

Thank you very much, Madam Secretary. I appreciate the fact that you are here today, and would like to say that you and your staff have really done an outstanding job on this issue.

You know, you really are, as you indicated, under somewhat of a burden at this particular time because we really don't know what the Republican proposal is. First, we started with the Shaw-Santorum bill in 1993. Then we had the Talent bill and then we had the Contract With America. And now they are talking about some form of—they call it block grant, but it could end up as a revenue sharing program.

I do feel that you are kind of speaking or maybe punching a marshmallow here because we really don't know what their proposal is, and, until we do, we are going to have a very difficult time responding to it.

I think what we need to do really is clarify a few things. One, I don't know how you really can do an adequate welfare reform bill unless you have health care because, as you stated in your testimony, approximately 70 percent of the women who are on welfare go off of welfare within 24 months. And the problem is that 65 percent of them—that is 65 percent of the 70 percent—end up within 1 year going back on welfare. And both Dr. Ellwood and Dr. Bane have showed graphically the demographics of the welfare population, and the real problem most people say is because health care benefits run out.

As Members on the other side of the aisle have indicated, women, like businesspeople, are going to do what is in their best interest. When they get a minimum wage job that does not cover them with health insurance, they are going to end up going back on welfare because that way they can at least cover their children with Medicaid benefits.

Tell me how we can possibly do welfare reform, in a comprehensive way, without dealing with the issue of health care for these people.

Secretary SHALALA. It is very tough, Congressman, as you have so eloquently stated. It is very tough to do welfare reform without child care and health care.

When you go out and ask welfare recipients what is it that is stopping them from finding a job, many of them—most of them will tell you their experiences getting out to get a job, often a minimum wage job. A child gets sick, and they have to go sit in a clinic. Their child care falls apart, and they are not able to make it to work that day.

And for every mother—and we are talking mostly about single mothers here—the combination of child care and health care and combined with what this Congress has already done on the earned income tax credit is a very powerful package for at least taking a significant percentage probably of the population and allowing it to stabilize itself in jobs.

And I think child care-health care combined with the earned income tax credit are very powerful tools for welfare reform. And I hope that we don't give up on the need to continue to look for some first steps, as the President indicated in his own letter to the leadership, for working families. Because what we are often talking about, the people that don't have health care in this country are often low-income workers, and being able to put that combination together I think is critical. That is why it is so hard to do all this.

Mr. MATSUI. It really is very difficult.

Let me discuss with you the further problem, the job training program, then the job search and then eventually the job. We in California were very innovative in the early eighties. We established the GAIN program. That program was actually the program that in 1988 President Clinton, then Governor Clinton, and others looked to in terms of reforming the welfare system at the national level, the 1988 welfare reform package, Family Support Act.

We have found—at least in studies I've seen, and perhaps your studies might show differently—but one of the most successful programs in the country is in Riverside County. There they have a public-private partnership between the county and the business community. That program has a success rate of 20 percent. That is the most successful program in the country, a 20 percent success rate. Do you anticipate how we can get that up to 40 or 30 percent, maybe 50 percent? Because we don't want to create expectations out there with the American public or perhaps expectations that nobody is going to be able to fulfill. What are your thoughts on that, allowing the private sector, which we need to do, to help these people find jobs?

Secretary SHALALA. Well, as I indicated at the beginning, this is tough to do. The experiments around the country have made it very clear that even the most successful programs demonstrate 20 percent. And we don't have the numbers in on the welfare waivers that we have granted around the country so we don't really know whether we are going to get larger numbers because most of those programs are in their infancy.

What we would like to try is what is clearly in the President's bill and in some elements of some of the earlier Republican bills, and that is a total immersion. And that is to change the culture of that welfare office so that everybody walks in with the intention of getting ready to work. And so that we have some of the support system in place so people can stay in the workplace, and child care is critical for that.

We believe that health care is also going to be a significant part and necessary. It is not only getting ready to get into the job but all of our experience is it is staying in the job. And what we have to organize and what the States are organizing themselves for is the support system to keep people in the jobs.

People seem to get their initial job. There is a high success rate of getting off welfare and getting into the first job. It is staying in the job. It is not rotating back into the system. And then, more than anything else, it is reaching that new generation with different expectations, with different standards, with different behaviors on behalf of the system.

But all of this is going to be very tough, and we have to go into it with an enormous amount of humanity and humility, which I think is even more important.

Chairman ARCHER. The gentleman's time has expired. The Chair recognizes Mrs. Kennelly to inquire.

Mrs. KENNELLY. Thank you, Madam Secretary. I heard you say, which is true, we all agree on a great many things. We agree that the individual, if possible, should live with the family. But, of course, there has to be a functional family. And what happens when that individual, that child is living in a welfare family and then a paternity——

I am so glad you pointed out that the person could say who the father was and be very clear about that and then have the State, which is notoriously slow in establishing paternity—right now I understand most States are 6 months behind in establishing a paternity—that the child shouldn't be penalized. The mother and child shouldn't be penalized if they have, in fact, tried to establish paternity.

But then you add also that we agree about training. Yes, but there has to be a job. So I think the Devil is in the details, that maybe our role is going to be making sure that we just don't all agree on these things and pat ourselves on the back and now we have done welfare reform and go home and find that the communities have increased poverty, the children are hungry, and there is homelessness.

As you keep saying—and I think I am saying the same thing—there is a lot of work to be done.

What I would like you to comment on, though, Madam Secretary, is something else we are struggling with and that is, yes, we are talking about block grants more and more, but do you foresee a capping on welfare, a capping on food stamps? Is there a possibility that we are going to agree on that also?

Secretary SHALALA. Well, I think on the President's proposal he feels that his proposal, which does not cap or block grant the major programs, because those programs have played a very important role in economic adjusting, and that is, as a State, if the State of Connecticut had a terrible economic downturn, there would be large numbers of workers, often low-income workers, who would need to come in for a very short period of time and get some food stamp benefits so that they could feed their families. And these programs have played an important role during recessions of kicking in for short periods of time.

It would be, in our judgment, a serious mistake to exclude hardworking folks who because of no fault of their own lose their jobs and need short-term help. And these programs have had the effect, during recessions in particular or other kinds of economic disasters, of cushioning the recession and stopping it from going wider and deeper. And, therefore, it is very important that we look at the economic effects of the way the programs are designed, in no way backing off from the kind of major reform that we think must take place centered on work and on proper parental responsibility.

Mrs. KENNELLY. Thank you. Let me take you further on that. That is what I worry about. I think we all agree the system is broken, the system doesn't work and that we have to reform it, but the block grant does have some limitations. There is no doubt about it.

You talked about child support enforcement, and that is another area which, when you look at block grants, sending back to the States—as I recall, having worked with this for years, one of the reasons we took it into the Federal area was because the States weren't putting it forth as a primary situation, and it had gone down to the bottom of the barrel. The judicial system didn't look at it. The Governors didn't look at it. So would you suggest that we do child support enforcement in a block grant fashion in the future?

Secretary SHALALA. You know, I haven't thought about that. The point that we have made about child support enforcement is that it is, in fact, a partnership where there are clear roles for the National Government, obviously, in the W–4 form new hire database as well as in the national clearinghouse of child support orders, and there are clear roles for the States.

How much uniformity we need ought to be part of our discussion. And we have had that discussion, Congress has had it, through the Interstate Commission. The Women's Caucus has had—has been part of this discussion. And I think that what I would say on our behalf is that there are clear, differential roles, and it is the kind of thing we ought to talk about. The important point is we ought to get it done, and it ought to be done now as part of this overall effort.

Mrs. KENNELLY. Thank you, Madam Secretary.

Chairman ARCHER. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman.

Welcome, Madam Secretary. As you know, Medicare accounts for roughly 16 percent of the spending in the Federal budget. Do you in the administration have any estimates about how much Medicare would have to be cut to provide for the tax cuts that are contained in the Contract that we are dealing with here today? Or would it have to be cut at all?

Secretary SHALALA. There is no question under the balanced budget amendment if we excluded Social Security and defense that it would be tough to protect the Medicare and the Medicaid programs. We're looking at cuts of 25 to 30 percent in both programs—about $100 billion in Medicare cuts, and $58 billion in Medicaid cuts in 2002. Cuts of this magnitude would certainly have a detrimental effect on program beneficiaries.

Mr. COYNE. Would it be your thinking, to the extent that there were cuts, that there would be increases in the premiums that seniors would have to pay for their benefits?

Secretary SHALALA. The President has said that he is not anxious and does not intend to cut Medicare, though there may be—unless it is directly related to health care reform. He has left a little flexibility in this area, and I think our budget will reflect his desire to protect the Medicare program. And I think I should leave it at that, and I don't want to anticipate anything that he has not either spoken on or intends to do.

Mr. COYNE. On another subject, on the welfare issue, has this idea of time limits for welfare recipients been tested anywhere in the country?

Secretary SHALALA. Actually, as part of the waivers, we have been—the States have been working with time limits.

I should say that Dr. Ellwood, Dr. Bane and I have been long advocates for time limits. We first made recommendations on time limits in 1986 as part of a report to the Governor of New York, so we have long believed that welfare should return to a transitional program to give people a hand up, and some of the experiments around the country have, that we have approved do have some limitations on them.

We also know—and one of the reasons that we are convinced that this will work is that 70 percent of the welfare recipients find jobs in 2 years and 90 percent in 5 years. So there is no reason to believe that serious time limits with genuine opportunity attached to them would not be useful, helpful and effective.

Mr. COYNE. So it is your experience that there has been, in limited instances, some positive results?

Secretary SHALALA. And if you look at the behavior of the current welfare population, there is some reason to believe that people do not stay on welfare for a very long period of time. They try to get off. And it is staying off that we have to focus on.

Mr. COYNE. Thank you.

Chairman ARCHER. Mr. Levin will inquire.

Mr. LEVIN. Thank you, Mr. Chairman.

Welcome. You know, I think some progress has been made here this morning in the search for common ground here probably more than some expected. I think as we continue the search for common ground we also have to be frank about why we differ.

And it isn't clear to me, for example, the proposal to eliminate benefits for teenage mothers. What drives that difference of opinion? Whether there is a difference of opinion if you withdraw benefits whether you automatically will change behavior. In a sense, that is saying that if you increase poverty, you will change conduct. Maybe so, but I think we have to be careful that we don't lose children in the meanwhile.

How much of it is budget driven? I think we have to ask ourselves honestly about that and other provisions. There may be different assessments about how we change human behavior, and it has been suggested this morning we need dynamic scoring not only on economic policy but on human behavior, but I think we need to be careful about that.

In that regard, let me ask you about the proposals to block grant. Do you have any idea how much of a reduction there would have been for the States if one of the proposals to block grant at a stationary level for 5 years had been in effect in the late eighties?

Secretary SHALALA. We are in the process of doing that run right now, and Assistant Secretaries Ellwood and Bane will be prepared to testify on that in the subcommittee later this week.

Mr. LEVIN. So you expect on Friday that we will have that information?

Secretary SHALALA. We are working on that information. I can't guarantee that we will have it on Friday, but we certainly are trying to take a look at what would happen if a block grant was—a block grant is proposed.

Mr. LEVIN. Let me express my hope that you will have some figures ready by Friday because, as you know, I had a disagreement with the Clinton proposal of a few years ago. I did not think there was adequate State flexibility in the administration's welfare proposal, because I am in favor of providing more flexibility to the States.

I do have concerns, though, about proposals that would block grant on a level funding basis without any kind of a notion as to what would happen in times of recession and in particular because recessions have tended in recent years to be somewhat regional in their impact.

The industrial States were hurt the most in the early eighties and then, as I remember it, Texas and some of the other Southwestern States were next and then California came after that. And I think, in view of that, we can't be sure that if there isn't some mechanism to respond to that that our motto would not in the end be budget driven more or as much by what was the actual impact on children pulling—being pulled out of poverty. So I will look forward to that.

But, again, Mr. Chairman, I think it is not only the spirit but some of the substance of the discussion today has given some glimmer of hope that maybe we will be able to find some common ground here if we are also honest with our differences. Thank you.

Secretary SHALALA. Congressman Levin, I think that your point is very well taken.

It was—I started to make it a little earlier, and that is about the economic stabilizer effect of these programs, that we have long used them in that way. And that if we moved to some other kind of approach and left these programs, these fundamental programs, to discretionary budgets, to caps coming down, to allocations every year, that would make it difficult for Governors to budget if the money didn't come in in October, if they couldn't be responsive to economic downturns that don't happen uniformly across the country. It would be low-income workers, workers who lost their jobs, who could not come in and use the programs on a temporary basis.

And I hope in the process of all of our focus, which is so heavily on teenagers and who is coming into the system, we don't forget about those hard-working Americans who have used these programs—food stamps, AFDC in particular—for very short periods of time when they were between jobs and all they wanted to do was to make sure that they had food on the table for their children.

Chairman ARCHER. Has the gentleman completed his inquiry?

Mr. LEVIN. Thank you very much.

Chairman ARCHER. Madam Secretary, thank you for your patience and for spending so much time with us today. I agree with my friend from Michigan. I think this has been an extremely constructive discussion and exchange today on an issue that really crosses party lines and covers something so important to everybody in this country. We need to find a way to do better, to find solutions to these problems, and I particularly thank you for that.

There are two very precise questions that I would like to ask you that I do not think have been developed in this hearing this morning. They are very quick. One is, can you identify the sources of revenue offsets for the $10 billion that your proposal would cost? Could you just quickly list those for us?

Secretary SHALALA. I am not sure I have them. I don't have them with me. We provided them to the committee last year, and we will provide them for the record.

Chairman ARCHER. All right.

[The following was subsequently received:]

FINANCING PROVISIONS

Vision

The financing for welfare reform comes from three areas: (1) reductions in entitlement programs; (2) extensions of various savings provisions set to expire in the future; and (3) better EITC targeting and compliance measures. Estimated Federal savings for all proposals are roughly $9.3 billion over five years.

A. ENTITLEMENT REFORMS

1. Cap the Emergency Assistance Program

Vision

The AFDC-Emergency Assistance (EA) Program is an uncapped entitlement program. In fiscal year 1990, expenditures totalled $189 million; by fiscal year 1999 they are projected to reach almost $1 billion. While the intent of the EA program is to meet short-term emergency needs and help keep people off welfare, States currently have wide latitude to determine the scope of their EA programs. Recently, States have realized that the definition of the program is so broad that it can fund almost any critical services to low-income persons. Some States have begun shifting costs from programs which the States fund primarily on their own such as foster care, family preservation, and homeless services into the matched EA program. States appear to be funding services that address long-term problems as well as true emergency issues.

Specifications

(a) Modify the current Emergency Assistance program by establishing a Federal cap for each State's EA expenditures. The cap will be set in fiscal year 1995 and increased by the Consumer Price Index in each subsequent year.

(b) The basic allocation formula is a combination of two components:

(i) Allocation among States proportional to their requested expenditures in 1994; and

(ii) Allocation among States proportional to their total AFDC spending in the previous year.

(c) There will be a ten-year transition period, and the weighting of the components will shift over time, with increasingly more weight being given to the second component. Beginning in 1995, the weighting will be 90 percent by component 1 and 10 percent by component 2. The weighting will be altered by 10 percentage points each year such that by 2004, the weighting will be 100 percent by component 2.

Rationale

The proposal ensures that all States will receive continued funding equal to their actual 1991 levels. The Federal match will continue at 50 percent up to the cap. This proposal raises about $1.60 billion over five years. The basic allocation formula balances the need to protect States that have been spending heavily on EA in and before 1994 with the potential claims of new States which have not previously had claims for services under EA.

2. Tighten Sponsorship and Eligibility Rules for Non-Citizens

Vision

In recent years, the number of non-citizens lawfully residing in the U.S. who collect SSI has risen dramatically. Immigrants rose from 5 percent of the SSI aged caseload in 1982 to over 25 percent of the caseload in 1992. Since 1982, applications for SSI from immigrants have tripled, while immigration rose by only about 50 percent over the period.

Most of the legal permanent resident applicants enter the country sponsored by their relatives, who agree as a condition of sponsorship that their relatives will not become public charges. To enforce this commitment, until this year, current law required that for 3 years, a portion of the sponsor's income in excess of 110 percent of poverty be "deemed" as available to help support the legal permanent resident (LPR) immigrant should they need public assistance. Currently, about one-third of the LPR immigrants on SSI subject to the deeming rules apply in their 4th year of residency. Last fall, to pay for extended unemployment benefits, Congress extended the time of deeming under SSI from three years to five years until 1996 when it reverts to three years again.

The Administration proposal related to non-citizens contains two parts—extending the deeming period for sponsor income and coordinating eligibility criteria under four Federal assistance programs.

Specifications

(a) Deeming Make the current five-year period of sponsor responsibility permanent law under the SSI program and extends from three years to five years sponsor responsibility under the AFDC and Food Stamp programs. The sponsor's income would be deemed as available to support the immigrant should they apply for public assistance. For the period beginning with six years after being lawfully admitted for permanent residence in the U.S. and until a sponsored immigrant attains citizenship status, if the sponsor has income above the U.S. median family income ($39,500), the sponsor will continue to be responsible for ensuring the support of the immigrant.

Rationale

This will have the effect of denying benefits to immigrants with sponsors with income above the median. Once immigrants attain citizenship, they will be eligible to apply for benefits on their own. Any immigrant whose sponsor is receiving SSI or AFDC benefits would be exempt from sponsor-to-alien deeming under SSI, AFDC and food stamps. The proposal affects applications after the date of enactment (i.e., it would grandfather current recipients as long as they remained continuously eligible for benefits). These changes in deeming rules would not apply to, and would have no effect on, Medicaid eligibility for immigrants. This part of the proposal saves about $2.8 billion over five years.

(b) Set consistent deeming rules for sponsored immigrants across three Federal programs (SSI, AFDC, and Food Stamps). Sponsor responsibility is based on longstanding immigration policy that immigrants should not become public charges.

Rationale

Sponsored immigrants most often apply for SSI benefits on the basis of being aged, and are different from most citizens in that the latter typically spent their life working and paying taxes in the U.S. At *the same time, this proposal ensures that truly needy sponsored immigrants will not be denied welfare benefits if they can establish that their sponsors are no longer able to support them, if their sponsors die, or if the immigrant becomes blind or disabled after entry into the U.S. The policy would not affect refugees or asylees.*

Vision

Currently, due to different eligibility criteria in statute, and litigation over how to interpret statutory language, the four Federal programs (SSI, AFDC, Medicaid, and Food Stamps) do not cover the same categories of non-LPR immigrants. For example, aliens whose departure the INS does not contemplate enforcing are eligible for SSI, but not for Food Stamps. The Food Stamp program has the most restrictive definition of which categories of non-LPR immigrants are eligible for benefits (i.e., the eligibility criteria encompass a fewer number of INS statuses). SSI and Medicaid have the most expansive definition of which categories of non-LPR immigrants are eligible for benefits, and the AFDC program falls between these extremes. This element establishes in statute a consistent definition of which non-LPR immigrants are eligible for welfare benefits.

(c) Eligibility criteria Establish similar eligibility criteria under four Federal programs (SSI, AFDC, Medicaid, and Food Stamps) for all categories of immigrants who are not legal permanent residents.

Rationale

This proposal makes eligibility criteria in the SSI, Medicaid, and AFDC programs similar to the criteria that currently exist in the Food Stamp program. The new list of INS statuses required for potential eligibility to the SSI, Medicaid, and AFDC programs is also virtually identical to those listed in the Health Security Act providing eligibility for the Health Security Card. Like the extended deeming provisions, this part of the proposal affects applications after date of enactment (i.e., it would grandfather current recipients as long as they remained continuously eligible for benefits). This part of the proposal saves about $900 million over five years.

3. New Rules Regarding SSI Benefits for Drug and Alcohol Addicted Recipients

Current Law

Current law requires that all SSI disability recipients for whom substance abuse is material to the finding of disability must be in available treatment and must have their payments made through a representative payee (a third party who receives and manages the funds). Payments to these SSI drug addict and alcoholic (DA&A) beneficiaries are suspended if the individual fails to participate in appropriate alcohol or drug treatment, if such treatment is available. No similar requirements are made of Social Security (Title II) disability beneficiaries who receive benefits on the basis of addictions. The representative payee and treatment requirements have been part of the SSI program since its inception over 20 years ago. However, the provisions have not been implemented effectively.

Specification

(a) Strengthen sanctions and apply new time limits to benefits paid to individuals receiving Supplemental Security Income (SSI) and Social Security Disability Insurance (SSDI) benefits who have substance abuse problems that are material to their disability finding.

Rationale

The Congress is reaching decisions on these proposals currently in conference on H.R. 4277, a bill which the Administration supports. We anticipate savings of $800 million over five years. Should the final bill yield savings of less than $800 million, we are committed to working with Congress to fully finance the package.

4. Income Test Meal Reimbursements to Family Day Care Homes

Current Law

The Child Care Food Program provides food subsidies for children in two types of settings: child care centers and family day care homes. They are administered quite differently. The subsidies in centers are well targeted because they are means-tested; USDA believes that over 90 percent of Federal dollars support meals served to low-income (below 185 percent of poverty) children. The family day care part of the program is not well targeted because it has no means test (due to the burden it would place on the providers). A USDA-commissioned study estimates that 71 percent of Federal food program dollars to family day care homes support meals for children above 185 percent of the poverty line. While the child care center funding levels have been growing at a modest rate, the family day care funding levels are growing rapidly--16.5 percent between 1991 and 1992.

Specifications

(a) Amend section 17(c) of the National School Lunch Act (42 U.S.C. 1766(c)) to establish a two-tiered reimbursement structure (in the Child and Adult Care Food Program) with a higher level of reimbursement for meals served by family day care homes located in low-income areas. Low-income areas would be defined as those in which half of the households have incomes below 185 percent of poverty. Family day care homes not located in low-income areas would have the option of receiving lower rates of meal reimbursement or administering a means test to enrolled children.

(b) Under the means tested option, meals served to children whose family income is below 185 percent of poverty would be reimbursed at the higher rate, while those served to children from higher income families would be reimbursed at the lower rate. Meals served to children enrolled in programs operated by low income providers would also be reimbursed at the higher rate. Finally, meals served to the day care providers' own children would continue to be means-tested.

(c) Provide family day home sponsoring organizations with an additional $10 per home per month for each home it sponsors in low-income areas. Authorize $2 million to States agencies for technical assistance to sponsors to help implement the new reimbursement system in FY 1995. Technical assistance funding would increase to $5 million in FY 1996. Authorize for FY 1997 through FY 2000 $5 million for the licensing of family day care homes in low-income areas.

Rationale

This approach better targets the family day care food program funding to low-income children and creates minimal administrative requirements for providers. This provision yields savings of about $500 million over five years.

5. Limit Deficiency Payments to Those Making $100,000+ from Off-Farm Income Per Year

Vision

USDA farm programs are criticized for unfairly supporting large farms and wealthy producers rather than smaller farms and lower-income farmers. The Congressional Office of Technology Assessment concluded that most big farms "do not need direct government payments and/or subsidies to compete and survive."

Specification

(a) Make producers receiving $100,000 or more in off-farm adjusted gross income ineligible for Commodity Credit Corporation (CCC) crop subsidies (price support loans and income support payments).

Rationale

The proposed targeting of subsidies would direct farm payments to smaller, family farms, which deserve Federal financial help more than large agricultural enterprises and individuals with sufficient off-farm income. It would cause an estimated 1-2 percent of program participants to drop out of USDA farm programs. Most of these wealthiest participants include corporations and individuals for whom farming is not a primary occupation or source of income. This proposal would save about $500 million over five years.

B. EXTEND EXPIRING PROVISIONS

1. Hold Constant the Portion of Food Stamp Overpayment Recoveries that States May Retain

Vision and Rationale

States are permitted to keep some portion of the 100-percent Federal Food Stamp recoveries as an incentive payment for pursuing program violations. This proposal raises about $100 million over five years.

Specification

(a) Extend the 1990 Farm Bill provision which reduced the percentage of recovered Food Stamp over-issuances retainable by State agencies for fiscal years 1991-95. Under this provision, which would be extended to fiscal years 1996-2004, States could retain 25 percent of recoveries from intentional program violations (previously 50 percent) and 10 percent of other recoveries (previously 25 percent).

2. Extend Fees for Passenger Processing and Other Custom Services

Vision and Rationale

A flat-rate merchandise processing fee (MPF) is charged by U.S. customs for processing of commercial and non-commercial merchandise that enters or leaves U.S. warehouses. The fee, adopted by OBRA 1986, generally is set at 0.19 percent of the value of the good. Other variable customs fees are charged for: passenger processing; commercial truck arrivals; railroad car arrivals;

private vessel or private aircraft entries; dutiable mail; broker permits; and barge/bulk carriers. NAFTA extended the MPF and other fees through September, 2003. This proposal would save about $1 billion in that year.

Specification

(a) Extend the fees through September, 2004.

3. Extend Railroad Safety User Fees

Vision and Rationale

Railroad safety inspection fees were enacted in the Omnibus Budget Reconciliation Act of 1990 to pay for the costs of the Federal rail safety inspection program. The railroads are assessed fees according to a formula based on three criteria: road miles, as a measure of system size; train miles as a measure of volume; and employee hours as a measure of employee activity. The formula is applied across the board to all railroads to cover the full costs of the Federal railroad safety inspection program. The fees are set to expire in 1996. The 1995 President's Budget proposed to extend the fees through 1999 and expand them, effective in 1995, to cover other railroad safety costs. The proposal raises about $200 million over five years.

Specification

(a) Extend the Railroad safety inspection fees permanently.

4. Extend Expiring Corporate Environmental Income (CEI) Tax Used to Finance Superfund

Vision and Rationale

A broad-based environmental tax, based on corporate alternative minimum taxable income (0.12 percent) in excess of $2 million, was first enacted in 1986 and is set to expire at the end of 1995.

Superfund reauthorization legislation would provide a further CEI tax extension through the year 2000, which would provide sufficient additional credit needed for budget scoring of the Superfund legislation's "orphan share" proposal. All revenue from the CEI tax extension, whether enacted in welfare reform or Superfund legislation, will continue to be dedicated to the Hazardous Substance Superfund to be used only for Superfund cleanups.

Specification

(a) Extend the CEI tax into 1998.

C. EITC TARGETING AND COMPLIANCE MEASURES

1. Deny EITC to Non-Resident Aliens

Vision and Rationale

Under current law, non-resident aliens may receive the Earned Income Tax Credit (EITC). Because non-resident taxpayers are not required to report their worldwide income, it is currently impossible *for the IRS to determine whether ineligible individuals (such as high-income nonresident aliens) are claiming the EITC. We estimate that about 50,000 taxpayers will be affected by our proposal, mainly visiting foreign students and professors. The proposal raises about $100 million over five years.*

Specification

(a) Deny the EITC to non-resident aliens completely.

2. Require Income Reporting for EITC Purposes for Department of Defense (DoD) Personnel

Vision and Rationale

Under current law, families living overseas are ineligible for the EITC. The first part of this proposal would extend the EITC to active military families living overseas. To pay for this proposal, and to raise net revenues, the DoD would be required to report the nontaxable earned income paid to military personnel (both overseas and States-side) on Form W-2. Such nontaxable earned income includes basic allowances for subsistence and quarters. Because current law provides that in determining earned income for EITC purposes such nontaxable earned income must be taken into account, the additional information reporting would enhance compliance with the EITC rules. The combination of these two proposals raises about $200 million over five years.

Specifications

(a) Extend the EITC to active military families living overseas.

(b) Require DoD to report the nontaxable earned income paid to military personnel (both overseas and States-side) on Form W-2.

Chairman ARCHER. Can you also tell me, under the work requirement where an individual does not comply and is removed from the rolls, under what circumstances can they reenter the rolls and become a part of the welfare system as a beneficiary under your program?

Secretary SHALALA. I am not sure they can come back in. Oh, they can come back if they are willing to work after 6 months. So they get a chance to come back and work.

Chairman ARCHER. Six months.

Secretary SHALALA. But they have to work. It is not coming back into the educational training. They have to come back to work.

Chairman ARCHER. I understand. At any point is there a lifetime cutoff or can this just occur over and over and over again?

Secretary SHALALA. There is a cutoff. Let me consult with my colleagues. The lifetime limitation is on the education and training program, not on the work program, so it is focused on the work program.

Mr. Chairman, let me say I appreciate your graciousness. I hope I was not rude to either you or any of your colleagues. Sometimes my enthusiasm gets ahold of me. You should not interpret it as anything else than our desire in this administration from working with you to produce real welfare reform, a substantial step forward. I think it is what the American people expect, and it certainly is what the President wants to do.

Chairman ARCHER. Well, I thank you very much. Your appearance here today I think has been a major step forward in attempting to find some bipartisan answers to this very, very knotty problem. So I am very grateful to you, and I know all the members of the committee are, also. Thank you very much.

Secretary SHALALA. Thank you.

Chairman ARCHER. For the benefit of the members, we intend to work right through the lunch period because we have many, many witnesses to hear, and members will have to accommodate their own appetites as best they can.

Our next witnesses will be members of the committee: Dr. McDermott and Mrs. Kennelly. Dr. McDermott, you may proceed. As a respected member of the committee, we welcome your testimony.

I see Mrs. Kennelly is here now. She can join you at the witness table. Will you proceed as she moves to the witness table?

I am going to encourage all witnesses to limit their testimony to the committee for 5 minutes. If it is anything in addition to that, it can be inserted into the record.

STATEMENT OF HON. JIM MCDERMOTT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Mr. MCDERMOTT. Thank you, Mr. Chairman. I appreciate the opportunity to testify today before this committee.

While the majority party has chosen to name the collective legislative proposals the Contract With America, a more accurate label, in my opinion, for this agenda is "The Private Health Insurance Price Increase Act of 1995."

It is absolutely clear that it will take massive cuts in Medicare and Medicaid to finance the Contract. As hospitals lose major financing, they will simply have to charge patients, particularly Medicare beneficiaries, more out of pocket and force greater hardship in terms of denied access to care. Prices raised on private patients will cause insurance premiums to skyrocket.

This, in my opinion, is nothing but a gigantic cost shift onto the private pocketbooks of the American people. The impact on the health insurance premiums for the average working family will be much greater than any tax increase one could reasonably imagine. However, it will be a silent, hidden tax increase for which Republicans will seek to avoid responsibility by attributing it to the vagaries of the holy marketplace of health care.

And no one on this committee should make a mistake about it. People will lose their medical care that they currently receive. Premiums will go up, and people will lose access to care. Who are those people who are going to lose the benefits? Mothers, children and grandparents of this Nation.

Look at one area, for example, children's hospitals. They rely on Medicaid on average for between 40 and 70 percent of their revenues. It is doubtful that one single children's hospital in this country would survive a fundamental disruption of the Medicaid funding. And if children's hospitals go out of business, not even the rich will be able to use them.

The hard truth is that we cannot contain costs in the public health sector alone without creating huge distortions throughout the entire delivery system. I think we really need to be honest with the American people about this. For a contract to be valid, there must be full understanding and a meeting of the minds on both sides.

When we talk about senior citizens—about giving seniors more choices, what we are really talking about is taking away their existing Medicare coverage, taking away their free choice of provider and giving them what I think is a worthless voucher that will force them into managed care.

It is simply a big lie to say we will increase senior citizens' choices. The voucher they will get will not be worth enough to actually purchase any insurance policy with Medicare benefits in this country today. They will have to pay more out of pocket for less choice and poorer access to care.

Now, contrary to the assertions made by the Speaker sitting at this table last week, managed care for seniors has not saved the taxpayers money; it has cost them money.

The GAO audit found that Medicare managed care companies were only insuring the healthy seniors who cost the Medicare program virtually nothing, and these companies received more money than Medicare would have paid for these beneficiaries under the traditional fee-for-service programs where the patient had free choice of provider.

No one knows whether managed care saves money when actually confronted with taking care of people who need medical services. But more importantly, what this committee is going to have to think about is what you are saying to young families in this country really is that, in addition to worrying about your own children's health care costs, you now will have to assume the health care costs of your parents and your grandparents, something people in this country have not had to worry about for 30 years. You can have a choice. You can watch them do without.

No one would sign such a contract, I believe. The Contract is more like a contract on America. It offers only chaos in the financing of our health care system. The challenge for Americans in the 104th Congress is to make sure that these disruptions do not occur. Thank you.

Chairman ARCHER. I thank the gentleman for his testimony.

The Chair will now recognize for her testimony another respected member of the committee, Mrs. Kennelly of Connecticut.

STATEMENT OF HON. BARBARA B. KENNELLY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CONNECTICUT

Mrs. KENNELLY. Thank you, Mr. Archer, and thank you, Mr. Chairman, for allowing me to testify.

I was absolutely delighted to see accelerated death benefits taken up in the Contract. This is a bill—and for new members, accelerated death benefits means that if in fact you find out that you are terminally ill, that you have 1 year or less to live and it is certified by a doctor that this is true, that you could collect on your life insurance.

This has two results. One, obviously you get better care because you are able to afford it. The other thing is it could be a situation where the taxpayers are going to have to pay for that health care, and this way you pay for your own health care.

This is a piece of legislation that I introduced in the 101st Congress. I got this idea from an insurance company in my district. It was a very innovative idea, and I became very involved in it.

It seemed like a simple piece of legislation. As time went on, I realized that it was getting complicated. So I turned to the Bush administration and began working with them on this, as I said, simple piece of legislation, to have people die in dignity and receive the benefits that they had paid for.

I didn't stop trying with the Bush administration. The Clinton administration came into office, and once again I started to promote this idea. The President put this idea of accelerated death benefits into his health care package and this very committee put it into our health care package when we addressed health care last year.

So it keeps getting so far, and that is why I was so glad to see it in the Contract. I am here today to give you some technical advice from my long experience with this bill so that you won't get caught up on those same points and not have this go through with the Contract or go through as quickly as it can.

First of all, I want to talk to you about not allowing these benefits to be discounted too much. When it first became apparent that this could happen, we really had some people—companies come forth. They weren't insurance companies, but companies sprouted up. We began to call them the grim reapers because what they would do is discount the policy by 55 percent. Then with a straight face would say, well, we can give 55 percent because expenses accounted for the rest.

I am sure nobody here would want to have anyone take advantage of the sick and be unscrupulous like that, and yet we had that experience, so I want to forewarn you on that.

The other thing that I ran into was tax treatment of the insurance companies that would treat this as a lien or really as a loan. We had many conversations with the Joint Tax Committee and the Treasury. They were very forward, up front that this wouldn't be abusive. It was just technical language and that this could be treated in that manner. And the point being get the money to the person who is sick before they die.

Then there was one third area that I wanted to bring up to you and that is the prohibition of acceleration of COLI, corporate-owned life insurance.

On this provision I also dealt with the Joint Tax Committee. The reason they were worried about this was that this could be used as a shelter.

That is not the point. The point is that it would be terminal, 1 year or less, certified through a doctor that you are going to die.

So I just really wanted to talk to you about those things so that you wouldn't run into what I ran into. Every time I thought we were going somewhere we had somebody either want to add an amendment or had some reason why we shouldn't do this.

The other thing we have talked about this morning, child support enforcement. I see it in your Contract. It is not in there to a great extent, but I think we really should talk about whether this should be in the Contract, should be in a block grant or, in fact, some of this should be kept with the Federal Government.

To answer Mr. Collins, we spend $1 to get $4 back in child support enforcement.

I worked for years on this in a bipartisan manner, began with Carroll Campbell, the former member of this committee and Governor, working on child support enforcement. We made our inroads—we got refunds on taxes, we have been able to use it concerning licensing, and it has been Federal efforts that have been able to increase our collection of child support enforcement.

There is a lot to be done, but we have made some progress. We should look at where this should come, but it should move forward.

Thank you, Mr. Archer, very much.

[The prepared statement follows:]

The Honorable Barbara B. Kennelly
Testimony before the House Ways and Means Committee
On Accelerated Death Benefits and Child
Support Enforcement and the Republican
Contract with America
Tuesday, January 10, 1995

Thank you Mr. Chairman. I appreciate the opportunity to come before the Committee today to discuss two issues in the Republican Contract I have long championed--accelerated death benefits on life insurance contracts and child support enforcement.

I introduced the very first accelerated death benefit legislation back in the 101st Congress when a small company in my district first brought this innovative product to my attention. The idea is to allow individuals who are certified by a physician to have a terminal illness or injury which can reasonably be expected to result in death within 12 months, to receive the proceeds of their life insurance contracts on a tax free basis.

This legislation had over 100 bipartisan cosponsors in the 102nd Congress including a number of members of this committee. I then worked closely with the Bush Administration in its attempt to accomplish this important goal by regulation. The regulations, however, were not final when the Clinton Administration took office and have not yet been finalized. The Administration subsequently included this provision in the President's Health Care plan. And this Committee included this provision in the health care reform bill it reported. A version of this legislation is included in the Republican Contract with America. And last week, I reintroduced this legislation with a number of bipartisan original cosponsors.

Mr. Chairman, at this point I would say that I hope we can move this legislation quickly, perhaps separately, and that it not be held back for any reason. Unfortunately, it was always held up because of amendments that would have complicated this very simple legislation. It clearly has bipartisan support. I would be pleased to work with you to find a way to pay for it.

I would like to make a number of technical comments regarding the version in the contract. First, my legislation includes a protection for beneficiaries by limiting the amount a policy can be discounted. The bill reported by this Committee contained a similar provision. I originally added this provision in response to reports that in some cases beneficiaries were only receiving 55% of the proceeds of their policies. The Contract contains no such protection and I think we should all be able to agree that the terminally ill ought not to be taken advantage of by the unscrupulous.

My bill also accords favorable tax treatment in those situations where these benefits are provided in the form of a lien. The bill reported by this Committee last year also included this provision. I assume that the fact this approach is missing from the Contract is simply an omission that can be corrected.

Finally, my bill contained a prohibition on the acceleration of Corporate Owned Life Insurance Policies (COLI). This provision was added after consultation with the Joint Committee on Taxation and Treasury in response to their concern about possible tax shelter opportunities. The Contract does not contain such a safe guard. I would hope that we could work together to assure that this important provision does not provide tax shelter opportunities.

In the area of child support enforcement, there has also been a long history of bipartisan cooperation. While past legislation has certainly improved collections for child support, we as a nation still have a long way to go. Only half of all custodial parents receive their full child support awards, leaving millions of children without adequate support. Congress must act to end this disgrace.

More than ten years ago, I fought to enact into law mandatory wage withholding from individuals with delinquent child support awards. In 1992, I served on the non-partisan U.S. Commission on Interstate Child Support, which issued a series of recommendations on how to improve child support enforcement, especially in difficult cases where the non-custodial parent resides in another state. Two years ago, I introduced legislation that reflects many of the Commission's recommendations, and again introduced this measure on the first day of the 104th Congress. Legislation introduced by the Womens' Caucus last year closely mirrors many of the provisions in my bill, titled the Interstate Child Support Act.

The Interstate Child Support Act would crack down on parents who are evading their responsibility by: enhancing the coordination for collecting child support across state lines, improving federal tracking of delinquent orders, withholding business and driver's licenses from individuals owing child support, and denying federal benefits to individuals with large unpaid child support awards.

While the Contract with America mentions child support enforcement, it contains very few details on how to improve the current system. I am also discouraged to hear that child support enforcement legislation might not be considered by this committee at all in the first 100 days of Congress.

Some members of this committee have urged that we send a strong message of personal responsibility to young mothers through welfare reform legislation. Can we really do this without sending an equally strong message to young fathers? We should also consider that improved child support enforcement might prevent some mothers from going on to welfare in the first place. And finally, we must remember that millions of Americans outside of the welfare system depend on child support, and they deserve a more effective enforcement system. For all of these reasons, I hope the Chairman will have the committee consider child support enforcement in the earliest possible time frame.

Thank you, Mr. Chairman. I would be pleased to respond to any questions the Committee may have.

Chairman ARCHER. My compliments to both of you. As usual, you have been very thoughtful and presented your comments exceedingly well.

I particularly am thankful to you, Mrs. Kennelly, for pointing out something that has almost been lost with so many other items in the Contract. It is a very, very important provision regarding the accelerated death benefits which will not only assist us in reducing the impact on taxpayers for health care but also on families who feel they have the obligation to take care of their loved ones. It could very well have a major beneficial impact on AIDS patients, for example.

It just shows that there is no monopoly on ideas on any side of the aisle. So, I congratulate you in your efforts to attempt to accomplish this, and we will, I believe, get it done with the Contract.

Mrs. KENNELLY. Thank you, Mr. Chairman.

Chairman ARCHER. Let me at this time turn over the chair to Mr. Crane because I am going to have to leave for a few minutes. He will recognize the members for inquiry.

Mr. CRANE [presiding]. First, Mr. Gibbons.

Mr. GIBBONS. Very briefly. Mr. McDermott, I want to thank you for bringing up the critical point that the most important thing we could do for welfare reform is to make sure that we get some adequate health care for those who would prefer to stay on welfare because it is the only way in which they can get coverage for their health care needs of their family. We can't really talk about welfare reform unless we make an integral part of it health care reform.

What do you think is the minimal amount that this Congress ought to do in this session in order to bring that question to a satisfactory solution?

Mr. MCDERMOTT. Well, I think, Mr. Gibbons, there are two groups that are, in my opinion, the most important groups to really look at. I don't think you should cut Medicare and Medicaid. I think there are ways in which to restructure it in a better form, but I don't think they should be cut.

There are two groups, however, that are really seriously problematic for this society. One is those between the ages of 65 and 50 who are being offered early retirement today but cannot take retirement because they do not have health insurance, and they have to hang on to the job. That has two effects: One, it keeps them in the job, and two, it prevents a younger person from getting a full-time job.

But an even larger area of concern to me—because 50 percent of the people in this country who have full-time jobs do not have health care benefits. When you look at all the people who are not covered, 50 percent of them are working full time. The temporary employee in this society—and business is structuring their hiring on a temporary basis.

And I think we have to do something for the young people in this country who come out of college, got all the training, go out and work full time and do not get benefits. You have to do that. Otherwise, they feel the system has let them down.

Mr. GIBBONS. Mrs. Kennelly, I want to thank you, too, for bringing up the two items that you brought up: Namely, the responsibility of both parents for their children and providing for them. We have got to solve these issues.

This item that we are working on, this welfare reform—I realize that some of the people that are penalized by a failure to be able to force family responsibility, financial responsibility, are not on welfare, but they are headed for welfare. And we are really hiding behind State sovereignty as an excuse for doing the correct thing about these children. Parents just escape responsibility by disappearing across State lines.

Mrs. KENNELLY. I thank you for bringing that up, Mr. Gibbons, because that is another thing I hope the committee does do.

Back, as I mentioned, when we began reform of child support enforcement in the 1984 amendments, it was a very extensive bill. What we did was bring back in the idea that there were not only those on welfare that were not getting child support but many people are not getting their court-ordered support—they have a court order in their hand and they are not getting that. And that was brought back in the mix so that that would keep people from falling back on to welfare.

So I hope we will address both the welfare client and the person that does not want to be on welfare.

Mr. GIBBONS. Thank you.

Mr. CRANE [presiding]. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman, and I thank the members of our panel for taking time to testify today and putting together excellent testimony. I just have one quick question for my colleague, Mr. McDermott.

It has to do with the health care issue, to follow on what Mr. Gibbons was speaking about. One point of clarification. You had said 50 percent of those who are uninsured have a full-time job but prior to that you had said that 50 percent of those working full time do not have health care. Which of those is correct?

Mr. MCDERMOTT. I misspoke at the beginning. It is 50 percent of those without health insurance who are working full time.

Mr. PORTMAN. Work full time?

Mr. MCDERMOTT. Yes.

Mr. PORTMAN. That is an important clarification. Thank you.

Mr. MCDERMOTT. Yes.

Mr. PORTMAN. I agree with you with regard to the cost shifting. I think it is irresponsible for us to continue to cut Medicare in particular through reimbursement and simply have the problem grow of private sector cost shifting.

You had indicated your willingness to look at the programs in a more systemic way, Medicaid and Medicare. I assume that we will be doing that. I hope we will be doing that in this committee and the full Congress, and I assume you would support that kind of undertaking to meet the kind of budget needs we are going to have.

Mr. MCDERMOTT. I certainly would welcome the opportunity to do real health care reform in this committee. It would be a nice way to finish the year, if we were able to actually do it.

But I think the crucial issue is going to be whether or not you think that everybody has to have health care in order to get control of cost. If you do not have universal coverage, can you control the cost?

I believe you have to have universal coverage, and I think that is the fundamental decision that we have to make in this committee if we are really going to control cost. Otherwise, we will continue what we have always done, which is shift the cost to somebody else, and the game really now is who can we pass the hot potato to, and right now we can cut Medicare but we are simply passing it to the private sector. That is not health care reform. I want to have universal coverage, get everybody covered with some kind of health care.

Mr. PORTMAN. Well, you have been a leader in that, clearly, and although your preferred approach was not successful last year, I would look forward to working with you, perhaps short of universal coverage, at least on reforming the system so that whatever cuts need to be made are done in a sensible way and not simply by means of a sleight of hand, which I consider the reimbursement cuts to be.

Thank you for your testimony. Thank you, Mrs. Kennelly.

Mr. CRANE. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman.

Just a brief comment, and thanking you for your testimony, I do hope, Mrs. Kennelly, that you will pursue, I know you will, your longtime effort to make sure we act on child support. I threw in a bill last year to provide another alternative, but you have been a leader here and I hope that we will wrap it into other action on welfare reform.

And, Mr. McDermott, let me say that sometimes when we raise the issue of Medicare, they say, well, in the legislation last year there were proposals for major reductions in Medicare payments to providers. But while that is true, it was combined with some reforms that would have provided some major increments to those providers that are truly under serious pressure. And I know you have been a leading spokesperson on that and I hope will remind people that the Medicare reductions proposed last year were combined with some major reforms, and if you do not put the two together, you are simply going to have some major detrimental impact on providers, some of whom are already under severe pressure. I think you may agree with that.

Mr. MCDERMOTT. I think, Mr. Levin, you are absolutely correct. The important thing to remember about last year's proposal was that the cuts were combined with universal coverage. And if you do not have universal coverage and you cut in one place, you simply shift those costs someplace else. And you have to have everybody in the system.

What is proposed in this Contract With America is that if you were going to balance the budget and you are going to do it without cutting Social Security and without cutting defense, by the year 2000, that is, between 1996 and 2000, you will have to cut $256 billion out of discretionary spending. And that means Medicare and Medicaid will get the biggest hits because they are the biggest programs. And that is why the proposal last year, that said, yes, you can make some cuts if you have got a situation where everybody is covered and you have the whole system working.

I think that is what is missing in the Contract With America, is there is no guarantee of universal coverage.

Mr. LEVIN. Thank you, very much, Mr. Chairman.

Mr. CRANE. Well, I thank you both for your testimony, and we have present now four of our colleagues; Mr. Traficant from Ohio, Ms. Pelosi from California, Mr. Goss from Florida, and Mr. Nadler from New York. If you will come up to the dais. And I think your colleagues will agree, ladies first.

STATEMENT OF HON. NANCY PELOSI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. PELOSI. Thank you very much, Mr. Chairman. Thank you for the opportunity to present my views on the potential impact of provisions of the Contract With America. I hope you will convey my gratitude to the chairman of the committee, Mr. Archer, for his making this time available for Members.

While I have many problems with the Contract, Mr. Chairman, I wanted to focus my comments today from the viewpoint of an appropriator and address the proposal to switch entitlement programs to discretionary spending, which I believe will only increase poverty, homelessness, and hunger for millions of American children.

Let me stipulate for the record that there is broad agreement that welfare programs need fundamental reform. Most welfare reforms initiated by States tie cuts in basic income support to employment and breaking the patterns that lead to long-term dependency. One of my great concerns is that the provisions in the Contract would indiscriminately cut basic income support without creating new opportunities for low-income people.

The authors of the Contract included language in the Personal Responsibility Act which would impose a cap on spending for income support programs for the poor. In the past, a number of Republicans and Democrats, for example our colleague, Mr. Stenholm, among others, had proposed placing a cap on total spending for all entitlements, except Social Security. The Contract is unique in that it places a cap only on the 6 percent of programs designed to assist the poorest Americans.

The authors of the Contract apparently assumed that savings of $40 billion from these safety net programs would finance other parts of the Contract, such as the reduction in the capital gains taxes, which would provide tax relief to some of the wealthiest of Americans. Thus, one could conclude, money being fungible, that the poor children in America are being placed in extreme peril to provide tax breaks for the privileged.

The Contract would also convert critical programs which are now entitlements, such as SSI and AFDC, into discretionary programs whose funding level would be set each year through the appropriations process. As a member of the Labor-HHS-Education Appropriations Subcommittee, which has struggled with the competing priorities for the poverty-related programs, I find this approach a source of extreme concern.

As you know, Mr. Chairman, the Budget Enforcement Act has established tight caps to restrain Federal discretionary spending. As a result of these caps, domestic discretionary spending will, by fiscal year 1998, consume a smaller share of the national economy than any year since 1962. Because the authors of the Contract call for increased defense spending, funding for priority domestic programs will be further constrained.

Adding income assistance programs to the competition for appropriated funds would almost certainly result in reductions far greater than those projected by the House Republican Conference. These crucial programs each will be reduced to the debilitating role of the baby bird fighting its brothers and sisters for the only worm. Those that are left to go hungry have no viable alternatives. This hunger is what needy children will face every day if these proposals become a reality.

It is my understanding there is now considerable interest among some Republican Governors and the authors of the Contract in replacing Federal safety net programs with block grants to the States. Such an approach would not only result in pain and suffering for poor people, particularly children, it would also hinder welfare reform efforts in some States.

Some States want to expand child care and job training programs for AFDC mothers to promote maximum employability. Because the block grant approach would provide much less money, States would be placed in the difficult position of further cutting benefits or abandoning reforms aimed at self-sufficiency. In my view, the Federal Government should be providing increased matching funds for States adopting such positive approaches.

In the interest of time, I have submitted my statement for the record, but I want to also call to your attention my concern about the SSI reductions, which I think are difficult to defend, and also want to address the specific provision of the financing proposal that relates to benefits for legal permanent residents. These legal immigrants have played by the rules, are here legally, and are tax paying. They are helping raise the next generation of Americans. By denying health benefits to the elderly, we are punishing the grandparents of the future generations of Americans.

Mr. Chairman, I want to say that government is a social contract with the American people. Thomas Jefferson wrote that, "The care of human life and happiness, and not their destruction, is the first and only legitimate object of good government." The Republican Contract, I believe, does not pass this test.

Mr. Chairman, once again, thank you for the opportunity to present my views on the critical issues before your committee. I hope to work with you in having real welfare reform which does not increase poverty in America.

[The prepared statement follows:]

STATEMENT OF
THE HONORABLE NANCY PELOSI
ON THE IMPACT OF THE CONTRACT ON LOW-INCOME AMERICANS
JANUARY 10, 1995

MR. CHAIRMAN, I APPRECIATE THE OPPORTUNITY TO PRESENT MY VIEWS ON THE POTENTIAL IMPACT OF PROVISIONS OF THE "CONTRACT WITH AMERICA" ON LOW-INCOME AMERICANS. IN PARTICULAR, I WANT TO EXPRESS MY CONCERN OVER PROVISIONS IN THE CONTRACT WHICH I BELIEVE WILL ONLY INCREASE POVERTY, HOMELESSNESS AND HUNGER FOR MILLIONS OF AMERICAN CHILDREN.

THE AID TO FAMILIES WITH DEPENDENT CHILDREN (AFDC) PROGRAM PROVIDES CASH TO NEEDY CHILDREN WHO LACK SUPPORT BECAUSE AT LEAST ONE PARENT IS DEAD, DISABLED, UNEMPLOYED, OR CONTINUALLY ABSENT FROM THE HOME. IN ADDITION TO THE PAYMENT, ELIGIBLE FAMILIES RECEIVE MEDICAID, ELIGIBILITY FOR FREE SCHOOL LUNCHES AND USUALLY FOOD STAMPS. FEDERAL LAW REQUIRES STATES TO REQUIRE ABLE-BODIED AFDC RECIPIENTS WITH NO CHILD UNDER AGE 3 TO PARTICIPATE IN THE STATE'S EDUCATION, TRAINING AND WORK PROGRAM, THE JOB OPPORTUNITIES AND BASIC SKILLS (JOBS) PROGRAM. APPROXIMATELY 5 MILLION FAMILIES ARE ENROLLED IN THE AFDC PROGRAM AND APPROXIMATELY 9.5 MILLION CHILDREN DEPEND ON THIS MONEY TO SURVIVE.

LET ME STIPULATE FOR THE RECORD THAT THERE IS BROAD AGREEMENT THAT WELFARE PROGRAMS, INCLUDING AFDC, NEED FUNDAMENTAL REFORM. REAL WELFARE REFORM HAS THE POTENTIAL TO MOVE INDIVIDUALS AND FAMILIES TOWARD LASTING SELF-SUFFICIENCY. BUT REAL WELFARE REFORM MUST BE REALISTIC IN RECOGNIZING THE CHALLENGES IN ACCOMPLISHING THESE GOALS. YES, WHERE SIMPLE LACK OF SELF-INITIATIVE IS THE CAUSE OF UNEMPLOYMENT, THE GOVERNMENT SHOULD NOT BEAR THE COST OF SUPPORTING THE INDIVIDUAL. BUT WE SHOULD ALSO RECOGNIZE THE DIFFICULTIES WHERE JOBS DO NOT EXIST, WHEN AN INDIVIDUAL IS UNABLE TO WORK BECAUSE OF A DISABILITY, OR WHEN DEPENDENT SMALL CHILDREN REQUIRE CARE.

MOST WELFARE REFORMS INITIATED BY STATES TIE CUTS IN BASIC INCOME SUPPORT TO EMPLOYMENT AND BREAKING THE PATTERNS THAT LEAD TO LONG-TERM DEPENDENCY ON INCOME SUPPORT. ONE OF MY GREAT CONCERNS IS THAT THE PROVISIONS IN THE CONTRACT WOULD INDISCRIMINATELY CUT BASIC INCOME SUPPORT WITHOUT CREATING NEW OPPORTUNITIES FOR LOW-INCOME PEOPLE.

THE AUTHORS OF THE CONTRACT INCLUDED LANGUAGE IN THE PERSONAL RESPONSIBILITY ACT WHICH WOULD IMPOSE A CAP ON SPENDING FOR INCOME SUPPORT PROGRAMS FOR THE POOR. IN THE PAST, A NUMBER OF REPUBLICANS AND DEMOCRATS, LIKE OUR COLLEAGUE MR. STENHOLM, AMONG OTHERS, HAVE PROPOSED PLACING A CAP ON TOTAL SPENDING FOR <u>ALL</u> ENTITLEMENTS EXCEPT SOCIAL SECURITY. THE CONTRACT IS UNIQUE IN THAT IT PLACES A CAP <u>ONLY</u> ON THE 6% OF PROGRAMS DESIGNED TO ASSIST THE POOREST OF AMERICANS. ACCORDING TO REPUBLICAN ESTIMATES, THE BILL WOULD ACHIEVE NET SAVINGS OF ABOUT $18 BILLION BY PLACING AN OVERALL SPENDING CAP ON AN ARRAY OF ANTI-POVERTY PROGRAMS. ADDITIONAL REDUCTIONS IN SPENDING OF $11 BILLION ARE PROJECTED FOR CONSOLIDATING MOST NUTRITION PROGRAMS INTO A BLOCK GRANT AND DECREASING THEIR FUNDING.

THE AUTHORS OF THE CONTRACT APPARENTLY ASSUME THAT SAVINGS FROM THESE SAFETY NET PROGRAMS WOULD FINANCE OTHER PARTS OF THE CONTRACT. OTHER PARTS OF THE CONTRACT, SUCH AS THE REDUCTION IN CAPITAL GAINS TAXES, PROVIDE TAX RELIEF TO SOME OF THE WEALTHIEST OF AMERICANS. THUS, ONE COULD CONCLUDE THAT POOR CHILDREN IN AMERICA ARE BEING PLACED IN EXTREME PERIL TO PROVIDE TAX BREAKS FOR THE RICH.

THE CONTRACT WOULD ALSO CONVERT CRITICAL PROGRAMS WHICH ARE NOW ENTITLEMENTS, SUCH AS THE SUPPLEMENTAL SECURITY INCOME PROGRAM (SSI) FOR DISABLED PEOPLE AND AFDC, INTO DISCRETIONARY PROGRAMS WHOSE FUNDING LEVEL WOULD BE SET EACH YEAR THROUGH THE APPROPRIATIONS PROCESS. AS A MEMBER OF THE LABOR-HHS-EDUCATION APPROPRIATIONS SUBCOMMITTEE WHO HAS STRUGGLED WITH THE COMPETING PRIORITIES FOR POVERTY RELATED PROGRAMS, I FIND THIS APPROACH A SOURCE OF EXTREME CONCERN.

AS YOU KNOW, THE BUDGET ENFORCEMENT ACT HAS ESTABLISHED TIGHT CAPS TO RESTRAIN FEDERAL DISCRETIONARY SPENDING. AS A RESULT OF THESE CAPS, DOMESTIC DISCRETIONARY SPENDING WILL, BY FY 1998, CONSUME A SMALLER SHARE OF THE NATIONAL ECONOMY THAN ANY YEAR SINCE 1962. BECAUSE THE

AUTHORS OF THE CONTRACT CALL FOR INCREASED DEFENSE SPENDING, FUNDING FOR PRIORITY DOMESTIC PROGRAMS WOULD BE FURTHER CONSTRAINED. IN ADDITION, THE RECENTLY ENACTED CRIME BILL HAS ESTABLISHED A TRUST FUND WHICH PROTECTS CRIME-RELATED SPENDING FROM REDUCTIONS IN DISCRETIONARY APPROPRIATIONS. NONETHELESS, ADDITIONAL CUTS IN DISCRETIONARY SPENDING ARE BEING ACTIVELY ADVANCED IN THIS CONGRESS.

ADDING INCOME ASSISTANCE PROGRAMS TO THE COMPETITION FOR APPROPRIATED FUNDS WOULD ALMOST CERTAINLY RESULT IN REDUCTIONS FAR GREATER THAN PROJECTED BY THE HOUSE REPUBLICAN CONFERENCE. THESE CRUCIAL PROGRAMS EACH WILL BE REDUCED TO THE DEBILITATING ROLE OF THE BABY BIRD FIGHTING ITS BROTHERS AND SISTERS FOR THE ONLY WORM. THOSE THAT ARE LEFT TO GO HUNGRY HAVE NO VIABLE ALTERNATIVES. THIS HUNGER IS WHAT NEEDY CHILDREN WILL FACE EVERY DAY IF THESE PROPOSALS BECOME REALITY.

AN INCREASE IN POVERTY FOR AMERICA'S CHILDREN WILL HAVE FAR-REACHING EFFECTS ON OUR NATION, AS WELL AS ON EACH CHILD. A THREE-YEAR STUDY BY THE CHILDREN'S DEFENSE FUND FOUND THAT FUTURE LOSSES TO THE ECONOMY STEMMING FROM ONE YEAR OF POVERTY FOR 14.6 MILLION CHILDREN RANGE FROM $36 BILLION TO $177 BILLION. THE STUDY, "WASTING AMERICA'S FUTURE", SAYS POVERTY PLACES CHILDREN AT HIGH RISK OF PHYSICAL OR MENTAL DISABILITY, EDUCATIONAL FAILURE AND TEEN PARENTHOOD.

BY ANY STANDARD, THE CUTS BEING PROPOSED IN THE SAFETY NET PROGRAMS FOR LOW INCOME PEOPLE ARE EXCESSIVE. THE PROPOSED CEILINGS ALONE WOULD IMPOSE BUDGET REDUCTIONS THREE TIMES GREATER THAN THOSE ENACTED IN 1981 AND 1982. SUBSEQUENT STUDIES INDICATED THAT THESE REDUCTIONS IN INCOME SUPPORT CONTRIBUTED TO INCREASES IN POVERTY THAT LASTED THROUGHOUT THE 1980'S. IT SHOULD BE NOTED THAT THESE DRASTIC REDUCTIONS IN INCOME SUPPORT WOULD NOT ONLY APPLY TO WELFARE RECIPIENTS, BUT ALSO TO INDIVIDUALS WHO HAVE BEEN FOUND TO BE MEDICALLY DISABLED AND COMPLETELY UNABLE TO WORK.

IT IS MY UNDERSTANDING THAT THERE IS NOW CONSIDERABLE INTEREST AMONG SOME REPUBLICAN GOVERNORS AND THE AUTHORS OF THE CONTRACT IN REPLACING FEDERAL SAFETY NET PROGRAMS WITH BLOCK GRANTS TO THE STATES. SUCH AN APPROACH WOULD NOT ONLY RESULT IN PAIN AND SUFFERING FOR POOR PEOPLE, PARTICULARLY CHILDREN, IT WOULD ALSO HINDER WELFARE REFORM EFFORTS IN SOME STATES. SOME STATES WANT TO EXPAND CHILD CARE AND JOB TRAINING PROGRAMS FOR AFDC MOTHERS TO PROMOTE MAXIMUM EMPLOYABILITY. BECAUSE THE BLOCK GRANT APPROACH WOULD PROVIDE MUCH LESS MONEY, STATES WOULD BE PLACED IN THE DIFFICULT POSITION OF FURTHER CUTTING BENEFITS OR ABANDONING REFORMS AIMED AT SELF-SUFFICIENCY. IN MY VIEW, THE FEDERAL GOVERNMENT SHOULD BE PROVIDING INCREASED MATCHING FUNDS FOR STATES ADOPTING SUCH POSITIVE APPROACHES. STATES SHOULD NOT BE COMPELLED TO ACCEPT A BLOCK GRANT IN ORDER TO OBTAIN INCREASED FLEXIBILITY. I AGREE WITH GOVERNOR HOWARD DEAN OF VERMONT, THE CHAIRMAN OF THE NATIONAL GOVERNORS ASSOCIATION, THAT BY SHIFTING INCOME ASSISTANCE PROGRAMS TO BLOCK GRANTS AND CUTTING SPENDING, THE PLAN COULD CRIPPLE STATE BUDGETS. AS YOU KNOW, GOVERNOR DEAN HAS DESCRIBED THE REPUBLICAN PLAN AS A POLICY "TO STARVE CHILDREN AND KICK OLD PEOPLE OUT OF THEIR HOUSES."

THE AUTHORS OF THE "CONTRACT WITH AMERICA" GO WELL BEYOND WELFARE REFORM DESIGNED TO MOVE PEOPLE FROM DEPENDENCY TO SELF-SUFFICIENCY. THE PROPOSED BUDGET-CUTTING MEASURES WOULD BE IMPOSED WITHOUT ANY SEEMING REGARD FOR MOVING PEOPLE FROM WELFARE TO WORK. THE REPUBLICAN PROPOSAL LIMITS ELIGIBILITY ON A WIDE RANGE OF INCOME ASSISTANCE PROGRAMS. THE PERSONAL RESPONSIBILITY ACT WOULD SHRED THE SOCIAL SAFETY NET. THIS PROPOSAL IS NOT ANTI-POVERTY - IT IS ANTI-POOR PEOPLE.

THE REDUCTIONS FOR SSI ARE EVEN MORE INEXPLICABLE. THE GOAL OF THE SSI PROGRAM IS TO PROVIDE INCOME SUPPORT TO PEOPLE WHO ARE FOUND TO BE MEDICALLY DISABLED FROM GAINFUL EMPLOYMENT. SSI PROVIDES MONTHLY CASH BENEFITS TO MORE THAN 6 MILLION AGED, BLIND AND DISABLED PEOPLE WITH LITTLE OR NO INCOME. TO REDUCE THEIR INCOME SUPPORT SIGNIFICANTLY TO FINANCE TAX BREAKS FOR MORE FORTUNATE AMERICANS SEEMS TO HAVE VERY LITTLE TO DO WITH PERSONAL RESPONSIBILITY.

CONVERTING SSI TO A DISCRETIONARY SPENDING PROGRAM WOULD PRESENT SOME VERY TOUGH CHOICES FOR REDUCING BENEFITS. ACCORDING TO THE CENTER ON BUDGET AND POLICY PRIORITIES, IF REQUIRED CUTS WERE DISTRIBUTED PROPORTIONATELY AMONG THE PROGRAMS UNDER THE CAP, SSI WOULD HAVE TO BE

CUT $5.1 BILLION, OR 15%, IN FY 1999. EITHER THE SOCIAL SECURITY ADMINISTRATION COULD ESTABLISH A WAITING LIST FOR OVER ONE MILLION ELIGIBLE AMERICANS WHO WOULD NOT BE RECEIVING ASSISTANCE, OR BENEFITS FOR THE ELDERLY AND DISABLED COULD BE REDUCED FROM $337 TO $287 A MONTH. AND THESE CUTS REQUIRED TO REMAIN WITHIN THE CAP WOULD GROW OVER TIME.

FINALLY, I WANT TO ADDRESS A SPECIFIC PROVISION OF THE FINANCING PROPOSAL FOR THE CONTRACT: THAT PROVISION WHICH DENIES BENEFITS TO LEGAL PERMANENT RESIDENTS. EVEN IF WE DISREGARD THE FACT THAT WE ARE PUNISHING PEOPLE WHO ARE LAWFULLY PAYING TAXES AND PLAYING BY THE RULES, THERE IS SOMETHING MORE FUNDAMENTALLY WRONG WITH THIS PROPOSAL. BY DENYING NEEDED ASSISTANCE TO LEGAL PERMANENT RESIDENTS, WE ARE DENYING OUR OWN FUTURE. THESE IMMIGRANTS ARE AND WILL BE THE FUTURE OF AMERICA. BY DENYING HEALTH BENEFITS TO THE ELDERLY, WE ARE PUNISHING THE GRANDPARENTS OF FUTURE GENERATIONS OF AMERICANS.

THIS PROPOSAL IS ESPECIALLY HARMFUL IN LIGHT OF THE PROPOSED PLAN TO CONVERT ENTITLEMENTS TO BLOCK GRANTS. THIS WOULD MAKE THE COMPETITION FOR SFAETY NET DOLLARS PARTICULARLY KEEN AND POTENTIALLY LEAD TO ANTI-IMMIGRANT FERVOR.

THIS VIEW IS SUPPORTED BY THE COMMISSION ON IMMIGRATION REFORM, CHAIRED BY OUR FORMER COLLEAGUE, REP. BARBARA JORDAN. IN ITS SEPTEMBER 1994 REPORT, THE COMMISSION FLATLY STATED THAT IT "RECOMMENDS AGAINST ANY BROAD CATEGORICAL DENIAL OF PUBLIC BENEFITS TO ILLEGAL IMMIGRANTS."

THE REPUBLICAN PARTY HAS A LONG HISTORY OF ACTING TO PROTECT THE WEALTHIEST AMERICANS AT THE EXPENSE OF AVERAGE AMERICANS. THE CONTRACT GOES BEYOND THIS TO TARGET THE DISABLED AND THE POOREST OF AMERICANS IN ORDER TO SUPPORT A VARIETY OF TAX REDUCTIONS SUCH AS CAPITAL GAINS FOR THE WEALTHY AND TAX CREDITS FOR FAMILIES MAKING UP TO $250,000 A YEAR. MR. CHAIRMAN, THE AMERICAN PEOPLE ARE FAIR MINDED AND DO NOT WANT TO SIMPLY TARGET THE 6% OF ENTITLEMENT PROGRAMS DESIGNED TO PROVIDE INCOME ASSISTANCE FOR POOR PEOPLE AS THE FINANCING MECHANISM FOR OTHER PROGRAMS IN THE CONTRACT.

GOVERNMENT IS A SOCIAL CONTRACT WITH THE AMERICAN PEOPLE. THE CONTRACT WITH AMERICA SHOULD NOT HAVE A PRICE TAG OUT OF REACH OF ORDINARY AMERICANS AND SHOULD NOT DISCRIMINATE AGAINST THE POOREST OF AMERICANS.

THOMAS JEFFERSON WROTE THAT "[T]HE CARE OF HUMAN LIFE AND HAPPINESS, AND NOT THEIR DESTRUCTION, IS THE FIRST AND ONLY LEGITIMATE OBJECT OF GOOD GOVERNMENT." THE CONTRACT WITH AMERICA DOES NOT PASS THIS TEST; INSTEAD, IT HAS THE POTENTIAL TO LEAVE OUT MILLIONS OF AMERICAN FAMILIES AND CONDEMN THEM TO A PLACE OUTSIDE THE POLICY OBJECTIVES OF GOVERNMENT.

MR. CHAIRMAN, ONCE AGAIN I WANT TO THANK YOU FOR THIS OPPORTUNITY TO PRESENT MY VIEWS ON THE CRITICAL ISSUES BEFORE YOUR COMMITTEE.

Mr. CRANE. Well, thank you, and let me say to all of the witnesses, if there is any extra material that you want submitted for the record, that will be done.

Mr. Traficant.

STATEMENT OF HON. JAMES A. TRAFICANT, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. TRAFICANT. Thank you, Chairman. Thank you for having me here.

I support the efforts of what the Republican Party is trying to do with the Contract With America. I do not support all of it and I will make those positions known on the House floor. But I do agree at least the Republican Party has a program that we can at least take off on, if we choose to, and I question my own party, to be honest about it.

I am here today about a specific piece of legislation I would like incorporated in and the opportunity to offer as an amendment to the Contract With America.

First, very simply this: If you are caught speeding on the highway by a State trooper coming here from Illinois, Chairman, that State trooper has to appear in court and he has to prove that you were speeding because you are innocent until proven guilty. And the amendment I want placed in here, for fairness, is in any court proceeding involving a tax matter with an American taxpayer, the burden of proof is on the Secretary. Very simple.

It is now legend, some of those practices and provisions. And the bill is straightforward. It says in any court proceeding the burden of proof is on the Secretary. The taxpayer, then, would be innocent until proven guilty, like a motorist going 90. Think of that a minute. I would ask that be made in order.

There are three revenue provisions here. Quite frankly, Ronald Reagan in 1981 had revenue provisions and he threw them out in 1986 after having dispatched both Carter and Mondale, because they lost money. And you are trying to find money. You are robbing Peter to pay Paul. We have yet to stabilize jobs in America. And I firmly believe that the November 8 election was turned around because of working people completely despaired with their party, the Democratic Party. They are wondering if there is any voice now on jobs.

The first two bills that I would like included raise approximately three-quarters of a billion dollars in revenue per year. First is the Foreign Subsidiary Tax Equity Act, in essence, would add a sixth category to foreign-based income: You have oil, sales, shipping, service, and investment under 954. The Traficant bill would add a sixth provision: Foreign-based manufacturing-related income.

There are a tremendous amount of incentives and loopholes that allow for the nonpayment of taxes and incentives to take American manufacturers overseas and to avoid the payment of taxes. It is legend with AT&T, that moved to Singapore. Whenever they, in Singapore, now build an addition, and put computers in, they, in fact, can escape the payment of tax to Uncle Sam. So we would add a sixth section under foreign-based income, manufacturing-related, in addition to oil, sales, shipping, service, and investment.

The second part of the tandem that, in fact, will contribute close to $3 billion a year in revenue, is repealing section 903. Here is how 903 works, to my new neighbor from Pennsylvania. When 903 was enacted, these were very unsophisticated foreign countries with very unsophisticated tax codes. They had an income tax code. But over the years they have evolved with the sophistication that has helped pull our jobs in, our subsidiaries. Under 903, any sales tax, excise fee, or value-added tax is a dollar-for-dollar credit against taxes paid Uncle Sam.

Repealing 903 would begin to take away these incentives of tax holidays and tax opportunities from American subsidiaries that have moved overseas. Changing 954, repealing 903, would, in fact, begin to stabilize and bring some consensus to an American tax policy with our subsidiaries overseas, take away some of those opportunities, and, in fact, create revenue.

The last one very simply, I know time is limited, is Ronald Reagan in 1981 came up with an investment tax program. He threw it out in 1986 because it lost money. Under the Reagan program you could buy a $10 million computer, you got a 10 percent tax credit of $1 million, accelerated cost recovery, and money was circulating and flowing and everyone was standing up cheering. One problem with it, though. If they bought that computer in Japan, $10 million went to Japan, the taxpayers gave a $1 million tax credit in accelerated cost recovery. We lost our pants. Reagan himself threw ITC out. I thought it was good.

The Traficant bill is very to the point. It is not only a 10 percent investment tax credit for business incorporation, it goes a step forward. It gives a 7 percent consumer tax credit for the purchase of manufactured durable goods. The condition in the change from the Reagan program: These raise revenue. That item must be made in America. If it is not made in America, it does not qualify for the credit.

We can have debates long and hard, and I am hoping the Democratic Party begins to look at this. None of these programs raise revenue. And this rising tide that was going to raise all these ships has not raised a damn thing around here.

I am prepared to debate it. The Constitution allows us to regulate commerce with foreign nations. Under this incentive, it would say this, and it also goes a step further with automobiles: You buy, in fact when a company invests in a $10 million computer system, if that computer system is made in America, they will get the $1 million. If it is not made in America, all they get is the standard depreciation.

On the 7 percent consumer tax credit proposal, it is very unique. I think our debt is so massive every one of us must be participants. We are fighting to give a tax break to people. Why not to participants in our economy? For example, you buy a $20,000 car: $1,400 tax credit. The Traficant bill captured $1,000 if that car is made in America. And if that car is made in America, you can deduct the sales tax and you can deduct the interest on the car note.

It stabilizes jobs. It increases revenue for Uncle Sam. And, yes, there has to be a debate, but I think it is time that we have that debate and I think the American people want that debate. So maybe I have gone a little too far, but I am asking, at least in the Contract With America, that the Republicans do something the Democrats would not do, look at the burden of proof in the tax case. It is the right thing to do. Appreciate your time.

[The prepared statement and attachments follow:]

JAMES A. TRAFICANT, JR.
17TH DISTRICT, OHIO

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CHAIRMAN, SUBCOMMITTEE ON PUBLIC BUILDINGS AND GROUNDS
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TESTIMONY OF THE HONORABLE JAMES A. TRAFICANT, JR. OF OHIO BEFORE THE HOUSE WAYS AND MEANS COMMITTEE JANUARY 10, 1995

First of all, Mr. Chairman, I would like to take this opportunity to thank you for permitting me to testify before the Committee. I know that Speaker Gingrich's promise of bi-partisanship is sincere, and I want you to know that I am ready to work with you and the committee to solve the many problems this country faces. We, as Members of the 104th Congress, have the responsibility of re-establishing the trust the American people have lost in the Federal government.

I would like to begin with a simple statement about what I feel is the root of this country's social and economic problems. I am talking about the crisis of poverty, welfare, an almost permanent annual trade deficit, unemployment, crime, and the ever growing division between the haves and the have-nots. I am talking about the trade and tax policies Congress has approved for the last four decades. Our trade and tax policies weaken America by allowing major employers to move operations overseas to take advantage of tax havens and holidays after handing out pink slips back home. Ironically, these policies have been pushed by both Republican and Democratic administrations.

Mr. Chairman, and members of the Ways and Means Committee, it is my firm belief that if we provide some real incentives for capital investment in America, slay the regulatory octopus that has strangled and frustrated American businesses, and remove the incentives that currently exist in the tax code for moving manufacturing operations overseas -- we will see a dramatic turnaround in the economic picture in this country.

Some aspects of the "Contract with America" have definite merit, and I commend the Republican leadership for putting these proposals on the table. Among those proposals in the Contract that I support are the repeal of the marriage tax, the $500 per child tax credit, the increase in the earnings limit for social security, the repeal of recent tax hikes on the elderly, and tax incentives for private long-term health care. The Republican Leadership is off to a good start, but I know that more can be accomplished.

I recently introduced four bills that, if enacted into law, will have a positive effect on America's economic and social future. I ask that you consider adding them to the tax package you are now working on. I would like to briefly describe my legislative package.

H.R. 248 would provide a 10 percent investment tax credit toward the purchase of an American-made durable good. Businesses and consumers would be able to deduct up to $1,000 for the purchase of an automobile, a computer, or a new machine. Part of the Contract calls for a capital gains tax, but I would respectfully ask the committee to consider an investment tax credit as well.

H.R. 249, the "Foreign Subsidiary Tax Equity Act," targets multinational corporations seeking tax havens by establishing subsidiaries overseas, despite the fact that America possesses the most productive and committed workforce in the world. These corporations leave to escape our regulatory laws and to utilize tax breaks. H.R. 249 would require U.S.-owned foreign subsidiaries that ship products back into the U.S. to pay the same level of U.S. taxes as American-based companies.

H.R. 250 would shift the burden of proof in all civil federal tax cases from the taxpayer to the IRS. Mr. Chairman, this is a measure I have championed for several years and would like to point out that this measure enjoyed the strong support of both Republicans and Democrats last year. In fact, more than 120 Members signed a discharge petition to force the bill from the Ways and Means Committee to the House floor for a vote. I certainly hope I won't have to resort to that tactic in the 104th Congress! Mr. Chairman, a basic tenet of the American justice system is "innocent until proven guilty." H.R. 250 simply ensures that this sacred principle is extended to every corner of our justice system. All too many lives have been ruined unjustly and without cause by an IRS that is all too often out of control. Most average Americans don't have the financial resources to do prolonged battle with the IRS. Most Americans, when accused by the IRS, simply pay the fine -- even though they know they did nothing wrong. Many of those who choose to fight either go broke all lose everything. My bill provides some modest safeguards to ensure that the IRS only brings a case when it has clear evidence that a taxpayer has engaged in fraud. Any tax reform measure approved by the 104th Congress should include this provision.

Lastly, H.R. 251 would repeal section 903 of the Internal Revenue Code. As you know, Section 903 extends creditability to those foreign taxes imposed "in lieu of" foreign income taxes. This means that all foreign taxes are creditable as business costs toward their foreign taxes paid. Conversely, domestic U.S. companies are put at a distinct disadvantage and are only able to deduct taxes that are "in lieu of" income taxes.

These proposals can do more to change the direction our country is going than any two years and out welfare reform program. Real and profound economic and social progress can be made in this country by approving the measures I have outlined, along with measures to simplify and lower income and corporate taxes, rationalize and reduce federal regulations, and overhaul ill-advised trade agreements such as GATT to protect American sovereignty.

Mr. Chairman, again, I want to thank you for affording me this opportunity to testify before your august body. I hope to work with you on these tax measures in the weeks and months ahead. I urge you to make my package of legislative proposals part of any tax reform measure sent to the floor by the committee.

At this time, I would be happy to answer any questions you might have.

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104TH CONGRESS
1ST SESSION

H. R. 389

IN THE HOUSE OF REPRESENTATIVES

Mr. TRAFICANT introduced the following bill; which was referred to the Committee on ____________________

A BILL

To discourage domestic corporations from establishing foreign manufacturing subsidiaries in order to avoid Federal taxes by including in gross income of United States shareholders in foreign corporations the retained earnings of any such subsidiary which are attributable to manufacturing operations in runaway plants or tax havens.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Foreign Subsidiary Tax Equity Act".

SEC. 2. INCOME FROM RUNAWAY PLANTS OR FROM MANUFACTURING OPERATIONS LOCATED IN A COUNTRY WHICH PROVIDES A TAX HOLIDAY INCLUDED IN SUBPART F INCOME.

(a) FOREIGN BASE COMPANY MANUFACTURING RELATED INCOME ADDED TO CURRENTLY TAXED AMOUNTS.—Subsection (a) of section 954 of the Internal Revenue Code of 1986 (defining foreign base company income) is amended by striking "and" at the end of paragraph (4), by striking the period at the end of paragraph (5) and inserting ", and", and by adding at the end thereof the following new paragraph:

"(6) the foreign base company manufacturing related income for the taxable year (determined under subsection (h) and reduced as provided in subsection (b)(5))."

(b) DEFINITION OF FOREIGN BASE COMPANY MANUFACTURING RELATED INCOME.—Section 954 of such Code is amended by adding at the end thereof the following new subsection:

"(h) FOREIGN BASE COMPANY MANUFACTURING RELATED INCOME.—

"(1) IN GENERAL.—For purposes of this section, the term 'foreign base company manufacturing related income' means income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with the manufacture for or sale to any person of personal property by the controlled foreign corporation where the property sold was manufactured by the controlled foreign corporation in any country other than the United States if such property or any component of such property was manufactured—

"(A) in a tax holiday plant, or

"(B) in a runaway plant.

"(2) OTHER DEFINITIONS; SPECIAL RULES.—For purposes of this subsection—

"(A) TAX HOLIDAY PLANT DEFINED.—The term 'tax holiday plant' means any facility—

"(i) operated by the controlled foreign corporation in connection with the manufacture of personal property, and

"(ii) with respect to which any economic benefit under any tax law of the country in which such facility is located accrued—

"(I) to such corporation,

"(II) for the purpose of providing an incentive to such corporation to establish, maintain, or expand such facility, and

"(III) for the taxable year of such corporation during which the personal property referred to in paragraph (1) was manufactured.

"(B) RUNAWAY PLANT DEFINED.—The term 'runaway plant' means any facility—

"(i) for the manufacture of personal property of which not less than 10 percent is used, consumed, or otherwise disposed of in the United States, and

"(ii) which is established or maintained by the controlled foreign corporation in a country in which the effective tax rate imposed by such country on the corporation is less than 90 percent of the effective tax rate which would be imposed on such corporation under this title.

"(C) ECONOMIC BENEFIT UNDER ANY TAX LAW DEFINED.—The term 'economic benefit under any tax law' includes—

"(i) any exclusion or deduction of any amount from gross income derived in connection with—

"(I) the operation of any manufacturing facility, or

"(II) the manufacture or sale of any personal property,

which would otherwise be subject to tax under the law of such country;

"(ii) any reduction in the rate of any tax which would otherwise be imposed under the laws of such country with respect to any facility or property referred to in clause (i) (including any ad valorem tax or excise tax with respect to such property);

"(iii) any credit against any tax which would otherwise be assessed against any such facility or property or any income derived in connection with the operation of any such facility or the manufacture or sale of any such property; and

"(iv) any abatement of any amount of tax otherwise due and any other reduction in the actual amount of tax paid to such country.

"(D) MANUFACTURE DEFINED.—The term 'manufacture' or 'manufacturing' includes any production, processing, assembling, or finishing of any personal property or any component of property not yet assembled and any packaging, handling, or other activity incidental to the shipment or delivery of such property to any buyer.

"(E) CORPORATION INCLUDES ANY RELATED PERSON.—The term 'controlled foreign corporation' includes any related person with respect to such corporation.

"(F) SPECIAL RULE FOR DETERMINING WHICH TAXABLE YEAR AN ECONOMIC BENEFIT WAS OBTAINED.—An economic benefit under any tax law shall be treated as having accrued in the taxable year of the controlled foreign corporation in which such corporation actually obtained the benefit, notwithstanding the fact that such benefit may have been allowable for any preceding or succeeding taxable year and was carried forward or back, for any reason, to the taxable year.

"(3) LIMITATION ON APPLICATION OF PARAGRAPH (1) IN CERTAIN CASES.—For purposes of this section—

"(A) IN GENERAL.—The term 'foreign base company manufacturing related income' shall not include any income of a controlled foreign corporation from the manufacture or sale of personal property if—

"(i) such corporation is not a corporation significantly engaged in manufacturing,

"(ii) the investment in the expansion of an existing facility which gave rise to a tax holiday for such facility was not a substantial investment, or

"(iii) the personal property was used, consumed, or otherwise disposed of in the country in which such property was manufactured.

"(B) CORPORATION SIGNIFICANTLY ENGAGED IN MANUFACTURING DEFINED.—

"(i) GENERAL RULE.—A corporation shall be deemed to be significantly engaged in manufacturing if the value of real property and other capital assets owned or controlled by the corporation and dedicated to manufacturing operations is more than 10 percent of the total value of all real property and other capital assets owned or controlled by such corporation.

"(ii) SPECIAL RULE FOR ASSESSING PROPERTY VALUE.—The value of any property owned by the corporation is the basis of such corporation in such property. The basis of the corporation in any property which was acquired other than by purchase shall be the fair market value of such property at the time of such acquisition. Any property controlled but not owned by such corporation under any lease (or any other instrument which gives such corporation any right of use or occupancy with respect to such property) shall be treated as property acquired other than by purchase in the manner provided in the preceding sentence.

"(C) SUBSTANTIAL INVESTMENT DEFINED.—The term 'substantial investment' means any amount which—

"(i) was added to the capital account for an existing facility during the 3-year period ending on the last day of any taxable year with respect to which such facility is a tax holiday plant, and "(ii) caused the sum of all amounts added to such account during such period to exceed 20 percent of the total value of such facility (determined in the manner provided in subparagraph (B)(ii)) on the first day of such period."

(c) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) The last sentence of subsection (b)(4) of such section 954 is amended by striking out "subsection (a)(5)." and by inserting in lieu thereof "subsection (a)(5) or foreign base company manufacturing related income described in subsection (a)(6)."

(2) Subsection (b)(5) of such section 954 is amended by striking out "and the foreign base company oil related income" and by inserting in lieu thereof "the foreign base company oil related income, and the foreign base company manufacturing related income".

(3) Subsection (b) of such section 954 is amended by inserting at the end thereof the following new paragraph:

"(9) FOREIGN BASE COMPANY MANUFACTURING RELATED INCOME NOT TREATED AS ANOTHER KIND OF BASE COMPANY INCOME.—Income of a corporation which is foreign base company manufacturing related income shall not be treated as foreign base company income of such corporation under any paragraph of subsection (a) other than paragraph (6)."

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 1988, and to taxable years of United States shareholders in which, or with which, such taxable years of foreign corporations end.

(2) INVESTMENTS BEFORE THE DATE OF ENACTMENT NOT TAKEN INTO ACCOUNT.—No facility of a foreign controlled corporation shall be treated as a tax holiday plant (within the meaning of section 954(h)(2)(A) of such Code, as amended by this section) or as a runaway plant (within the meaning of section 954(h)(2)(B) of such Code, as amended by this section) on the basis of any amount paid or incurred with respect to such facility and added to the capital account for such facility before the date of the enactment of this Act.

104TH CONGRESS
1ST SESSION

H. R. 392

IN THE HOUSE OF REPRESENTATIVES

Mr. TRAFICANT introduced the following bill; which was referred to the Committee on ______________

A BILL

To amend the Internal Revenue Code of 1986 to reinstate a 10-percent domestic investment tax credit, to provide a credit for the purchase of domestic durable goods, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Investment for America Act".

SEC. 2. REINSTATEMENT OF 10-PERCENT DOMESTIC INVESTMENT TAX CREDIT.

(a) ALLOWANCE OF CREDIT.—Section 46 of the Internal Revenue Code of 1986 (relating to amount of investment credit) is amended by striking "and" at the end of paragraph (2), by striking the period at the end of paragraph (3) and inserting ", and", and by adding at the end thereof the following new paragraph:

"(4) the domestic investment credit."

(b) AMOUNT OF CREDIT.—Section 48 of such Code is amended by adding at the end thereof the following new subsection:

"(c) DOMESTIC INVESTMENT CREDIT.—

"(1) IN GENERAL.—For purposes of section 46, the domestic investment credit for any taxable year is an amount equal to 10 percent of the qualified investment for such taxable year.

"(2) QUALIFIED INVESTMENT.—

"(A) IN GENERAL.—For purposes of paragraph (1), the qualified investment for any taxable year is the aggregate of—

"(i) the applicable percentage of the basis of each new domestic section 38 property placed in service by the taxpayer during such taxable year, plus "(ii) the applicable percentage of the cost of each used domestic section 38 property placed in service by the taxpayer during such taxable year.

"(B) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A), the applicable percentage for any property shall be determined under paragraphs (2) and (7) of section 46(c) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990).

"(C) CERTAIN RULES MADE APPLICABLE.—The provisions of subsections (b) and (c) of section 48 (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) shall apply for purposes of this paragraph.

"(3) DOMESTIC SECTION 38 PROPERTY.—For purposes of this subsection, the term 'domestic section 38 property' means any section 38 property if—

"(A) the property was completed in the United States, and

"(B) at least 60 percent of the basis of the property is attributable to value added within the United States.

For purposes of the preceding sentence, the term 'United States' includes the Commonwealth of Puerto Rico and the possessions of the United States.

"(4) SECTION 38 PROPERTY.—For purposes of this subsection, the term 'section 38 property' means—

"(A) tangible personal property (other than an air conditioning or heating unit), or

"(B) other tangible property (not including a building and its structural components) but only if such property—

"(i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

"(ii) constitutes a research facility used in connection with any of the activities referred to in clause (i), or

"(iii) constitutes a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state), or

"(C) elevators and escalators, but only if—

"(i) the construction, reconstruction, or erection of the elevator or escalator is completed by the taxpayer, or

"(ii) the original use of such elevator or escalator commences with the taxpayer, or

"(D) single purpose agricultural or horticultural structures; or

"(E) a storage facility (not including a building and its structural components) used in connection with the distribution of petroleum or any primary product of petroleum.

Such term includes only property to which section 168 applies without regard to any useful life and any other property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 3 years or more.

"(5) COORDINATION WITH OTHER CREDITS.—This subsection shall not apply to any property to which the energy credit or rehabilitation credit would apply unless the taxpayer elects to waive the application of such credits to such property.

"(6) CERTAIN PROGRESS EXPENDITURE RULES MADE APPLICABLE.—Rules similar to rules of subsection (c)(4) and (d) of section 46 (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) shall apply for purposes of this subsection."

(c) TECHNICAL AMENDMENTS.—

(1) Subparagraph (C) of section 49(a)(1) of such Code is amended by striking "and" at the end of clause (ii), by striking the period at the end of clause (iii) and inserting ", and", and by adding at the end thereof the following new clause:

"(iv) the basis of any new domestic section 38 property and the cost of any used domestic section 38 property."

(2) Subparagraph (E) of section 50(a)(2) of such Code is amended by inserting "or 48(c)(6)" before the period at the end thereof.

(3) Paragraph (5) of section 50(a) of such Code is amended by adding at the end thereof the following new subparagraph:

"(D) SPECIAL RULES FOR CERTAIN PROPERTY.—In the case of any domestic section 38 property which is 3-year property (within the meaning of section 168(e))—

"(i) the percentage set forth in clause (ii) of the table contained in paragraph (1)(B) shall be 66 percent,

"(ii) the percentage set forth in clause (iii) of such table shall be 33 percent, and

"(iii) clauses (iv) and (v) of such table shall not apply."

(4)(A) The section heading for section 48 of such Code is amended to read as follows:

"SEC. 48. OTHER CREDITS."

(B) The table of sections for subpart E of part IV of subchapter A of chapter 1 of such Code is amended by striking the item relating to section 48 and inserting the following:

"Sec. 48. Other credits."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to periods after December 31, 1994, under rules similar to the rules of section 48(m) of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990).

SEC. 3. CREDIT FOR PURCHASES OF DOMESTIC DURABLE GOODS.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1986 (relating to nonrefundable personal credits) is amended by inserting after section 22 the following new section:

"SEC. 23. PURCHASES OF DOMESTIC DURABLE GOODS.

"(a) GENERAL RULE.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to 7 percent of the aggregate amount paid during the taxable year for the purchase of domestic durable goods.

"(b) DOMESTIC DURABLE GOODS.—For purposes of this section—

"(1) IN GENERAL.—The term 'domestic durable good' means any durable good if—

"(A) the property was completed in the United States, and

"(B) at least 60 percent of the basis of the property is attributable to value added within the United States.

"(2) UNITED STATES.—The term 'United States' includes the Commonwealth of Puerto Rico and the possessions of the United States.

"(c) LIMITATION.—The amount of the credit allowed under subsection (a) for any taxable year shall not exceed $1,000."

(b) CONFORMING AMENDMENT.—The table of sections for such subpart A is amended by inserting after the item relating to section 22 the following new item:

"Sec. 23. Purchases of domestic durable goods."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1994.

SEC. 4. CREDIT FOR CERTAIN COSTS INCURRED IN PURCHASING AN AMERICAN-MADE PASSENGER VEHICLE.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1986 (relating to nonrefundable personal credits) is amended by inserting after section 23 (as added by section 3 of this Act) the following new section:

"SEC. 24. CERTAIN COSTS INCURRED IN PURCHASING AN AMERICAN-MADE PASSENGER VEHICLE.

"(a) IN GENERAL.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the qualified payments made by the taxpayer during such year.

"(b) QUALIFIED PAYMENTS.—For purposes of this section, the term 'qualified payments' means any payment of—

"(1) any State or local sales tax imposed on the purchase by the taxpayer of any qualified automobile, and

"(2) any interest on any loan which is secured by a qualified automobile and which was incurred by the taxpayer to purchase such automobile.

"(c) QUALIFIED AUTOMOBILE.—For purposes of this section, the term 'qualified automobile' means any automobile (as defined in section 4064(b))—

"(1) which is purchased after December 31, 1994,

"(2) which is domestically produced,

"(3) the original use of which begins with the taxpayer, and

"(4) substantially all of the use of which is for personal, nonbusiness purposes.

For purposes of the preceding sentence, an automobile is domestically produced if more than 60 percent of the automobile is produced in the United States and its final assembly occurs in the United States.

"(d) DENIAL OF DOUBLE BENEFIT.—No deduction or credit shall be allowed under any other provision of this title for any payment for which a credit is allowable under this section."

(b) CLERICAL AMENDMENT.—The table of sections for such subpart A is amended by inserting after the item relating to section 23 the following new item:

"Sec. 24. Certain costs incurred in purchasing an American-made passenger vehicle."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after December 31, 1994.

SEC. 5. PLACEMENT OF MADE IN AMERICA LABELS ON PRODUCTS.

(a) REQUIREMENTS FOR USE OF LABELS.—No product may bear a label which states or suggests that the product was made in America unless—

(1) the product has been registered with the Department of Commerce under subsection (b); and

(2) the Secretary of Commerce has determined that—

(A) 60 percent of the product was manufactured in the United States; and

(B) final assembly of the product took place in the United States.

(b) REGISTRY OF AMERICAN-MADE PRODUCTS.—Not later than 12 months after the Secretary has promulgated regulations regarding the registration of products with the Department of Commerce under this section, a person shall register with the Department of Commerce any product on which there is or will be affixed a label which states or suggests that the product was made in America.

(c) PENALTIES FOR FRAUDULENT USE OF LABELS.—

(1) CIVIL FINE.—Any person who, with an intent to defraud or mislead, places on a product a label which states or suggests that the product was "made in America" in violation of this section may be assessed a civil penalty by the Secretary of not more than $100,000. The Secretary may issue an order assessing such civil penalty only after notice and an opportunity for an agency hearing on the record. The validity of such order may not be reviewed in an action to collect such civil penalty.

(2) INJUNCTIVE RELIEF.—The Secretary may bring an action to enjoin the violation of, or to compel compliance with, this section, whenever the Secretary believes that such a violation has occurred or is about to occur.

(d) REGULATIONS.—Not later than 12 months after the date of the enactment of this Act, the Secretary shall promulgate regulations establishing procedures under which a person shall register a product under this section.

(e) DEFINITIONS.—For purposes of this section:

(1) LABEL.—The term "label" means any written, printed, or graphic matter on, or attached to, a product or any of its containers or wrappers.

(2) SECRETARY.—The term "Secretary" means the Secretary of Commerce.

103D CONGRESS
2D SESSION

H. R. 390

IN THE HOUSE OF REPRESENTATIVES

Mr. TRAFICANT introduced the following bill; which was referred to the Committee on ____________

A BILL

To amend the Internal Revenue Code of 1986 to provide that the burden of proof shall be on the Secretary of the Treasury in all tax cases, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. BURDEN OF PROOF.

(a) GENERAL RULE.—Chapter 77 of the Internal Revenue Code of 1986 (relating to miscellaneous provisions) is amended by adding at the end thereof the following new section:

"SEC. 7524. BURDEN OF PROOF.

"Notwithstanding any other provision of this title, in the case of any court proceeding, the burden of proof with respect to all issues shall be upon the Secretary."

(b) CLERICAL AMENDMENT.—The table of sections for chapter 77 of such Code is amended by adding at the end thereof the following new item:

"Sec. 7524. Burden of proof."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 2. SECRETARY OF THE TREASURY REQUIRED TO SPECIFY, ON REQUEST, REGULATIONS IMPLEMENTING SPECIFIC TAXES.

(a) IN GENERAL.—Section 6001 of the Internal Revenue Code of 1986 (relating to notice or regulations requiring records, statements, and specific returns) is amended by inserting "(a) IN GENERAL.—" at the beginning of the first sentence and by adding at the end the following new subsection:

"(b) REQUESTS FOR IDENTIFICATION OF IMPLEMENTING REGULATIONS.—The Secretary shall identify in writing the specific kind or type of tax, and its specific implementing regulations within 14 days, upon the written request from any person made liable for the payment of any tax under this title."

(b) CONFORMING AMENDMENT.—Subsection (a) of section 6001 of such Code, as redesignated by subsection (a), is amended—

(1) by striking "any tax" in the first sentence and inserting "any kind or type of tax", and

(2) by striking "he may require" in the second sentence and inserting "he shall require".

SEC. 3. INCREASE IN LIMIT ON RECOVERY OF CIVIL DAMAGES FOR UNAUTHORIZED COLLECTION ACTIONS; EXCLUSION OF SUCH DAMAGES FROM INCOME.

(a) INCREASE IN LIMIT.—Subsection (b) of section 7433 of the Internal Revenue Code of 1986 (relating to damages) is amended by striking "$100,000" and inserting "$1,000,000".

(b) EXCLUSION FROM INCOME.—Section 7433 of such Code is amended by adding at the end the following new subsection:

"(e) EXCLUSION OF DAMAGES FROM INCOME.—Damages awarded under this section shall be excluded from gross income under this title."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to actions by officers or employees of the Internal Revenue Service after the date of the enactment of this Act.

104TH CONGRESS
1ST SESSION

H. R. 391

IN THE HOUSE OF REPRESENTATIVES

Mr. TRAFICANT introduced the following bill; which was referred to the Committee on ________________

A BILL

To amend the Internal Revenue Code of 1986 to deny the foreign tax credit and deduction for taxes paid in lieu of income taxes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DENIAL OF FOREIGN TAX CREDIT AND DEDUCTION FOR TAXES PAID IN LIEU OF INCOME TAXES.

(a) IN GENERAL.—Section 903 of the Internal Revenue Code of 1986 (relating to credit for taxes in lieu of income, etc., taxes) is hereby repealed.

(b) CLERICAL AMENDMENT.—The table of sections for subpart A of part III of subchapter N of chapter 1 of such Code is amended by striking the item relating to section 903.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1994.

Mr. CRANE. I thank the gentleman for his testimony.
Mr. Nadler.

STATEMENT OF HON. JERROLD NADLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. NADLER. Thank you, Mr. Chairman. First, let me express my appreciation to the committee for its willingness in hearing my testimony this morning, and I have two subjects of testimony.

First, in 1993, many of us worked to stop a proposal which many of us found to be extremely troubling and discriminatory to seniors nationwide, and I refer, of course, to the proposal to increase the proportion of Social Security subject to taxation from 50 to 85 percent above certain income levels.

Congresswoman Carolyn Maloney, Nita Lowey, Bernie Sanders, and I introduced an amendment to remove this provision in the Omnibus Reconciliation Act. Unfortunately, the Rules Committee did not make this amendment in order. This provision was passed and adopted into law as part of the Omnibus Reconciliation Act, and it provides that single Social Security recipients with taxable incomes over $34,000 and married recipients with joint taxable incomes over $44,000 will now find 85 percent of their benefits subject to income tax rather than the 50 percent of benefits previously subject to taxation.

There is agreement on this issue that goes beyond the bounds of partisan politics. There is agreement on both sides of the aisle that this tax increase is grossly unfair. Shortly after the passage of the Omnibus Reconciliation Act, Congresswoman Nita Lowey and I and several other Members introduced H.R. 2987, which would have repealed this unfair tax immediately. This week we are reintroducing legislation to accomplish this goal.

Our plan differs from H.R. 8 in one significant way. First, our legislation would repeal this tax increase immediately. I believe that it is unjust to force a senior citizen to wait for 5 years until Congress figures out how to balance the budget. If we do.

It was wrong to focus a tax increase only on older Americans. They have been paying this unjust increase and we should not compound the injustice by asking them to continue to pay any part of this increase beyond this year.

Additionally, while we agree on the fundamental principles underlying this legislation, H.R. 8 does not address the question of offsetting revenue. I believe we should deal honestly and openly with the question of how we should pay for this revenue.

This issue is one of particular concern to my constituents in New York where, because of a very high cost of living, an income of $34,000 is very, very far from wealthy. The application of this tax increase has been especially unfair and burdensome to my neighbors living on Social Security. I urge the committee to repeal it now, not in 5 years.

The second subject I wanted to mention is section 277 of the Tax Code, which as long as we are dealing with the taxes, we should pay attention to now. This provision is a rather obscure provision originally enacted with the intention of closing a loophole by which country clubs and golf clubs were making sums of money on interest and other income and were escaping taxation.

The IRS ruled a few years ago retroactive to 1986, that co-ops and condos were subject to this tax on income in their reserve funds. Now, many States require co-ops, not condos, or sometimes condos but mostly co-ops, require a co-op to have a reserve fund to provide for funds if the roof needs repair or some other major capital improvement must be done. And so these co-ops and condos maintain the reserve funds. They keep them in a bank and earn interest. And suddenly they now find that with 8 years of retroactivity the IRS is giving interpretation to section 277 that no one ever anticipated, and large sums are being demanded, such that in many cases will throw these co-ops into bankruptcy and upset the entire situation.

I don't remember the exact figure that it would cost to repeal this. It is a small figure for the country. Congressman Rangel and Congressman Schumer both have legislation introduced in prior years, Senator Moynihan also, to change this egregious misinterpretation of the statute to impose a tax never anticipated by Congress, which was done by the IRS and done retroactively, as I said, and I hope that you will take this opportunity to eliminate this provision retroactive to 1986, to adopt Congressman Rangel's bill on the subject and incorporate it into whatever else is done this year so that we can eliminate this threat to the financial stability of many co-ops and condos throughout the country.

We all say that we want homeownership, especially middle-class homeownership. We want to encourage co-ops and condos middle-class homeownership. This is a direct threat to hundreds of thousands of units in New York and elsewhere. So I hope you will give it every consideration, and I thank you for your courtesy and members of the committee.

Mr. CRANE. Thank you, Mr. Nadler.

And next, Mr. Goss.

STATEMENT OF HON. PORTER J. GOSS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. GOSS. Thank you very much, Mr. Chairman. I congratulate you on these hearings and you and your members of this committee for taking the time. It is critically important and I know the people of America are fascinated with what is going on here and looking for a good outcome.

I want to submit an amended updated statement for the record in addition to the one I have given you for your packets, which has some new information in it, and let that stand as my statement and make a few remarks, if that is permissible.

Mr. CRANE. Absolutely.

Mr. GOSS. Thank you, Mr. Chairman.

Mr. Chairman, I come from a part of the country in southwest Florida, which is a wonderful place to live and a great place to retire. As a result I represent an awfully large number of senior citizens. I can tell you that the Senior Citizens' Equity Act is being watched very closely by the people in my district because they believe it corrects some serious problems and some great unfairness that exists with regard to our senior citizens in this country.

I have just completed a term of serving on the Bipartisan Entitlement and Tax Reform Commission, known also as the Kerrey

Commission, and I think we all understand there are some serious problems facing us out there that we are going to have to deal with. They are generational they are so large. We have years ahead to plan for these.

But before we get to those big, big issues of entitlements and how we handle them, there are some short-term fixes that we can make. And in the Senior Citizens' Equity Act, I think there are several that we should get on with immediately. The first, of course, is the earnings test limitation.

Coming from where I do, the earnings test has about equal billing with the notch as a subject when I go to a town meeting. And I think that that probably gives you an idea of the amount of interest there and the amount of correspondence I get on it.

I think that phasing out the earnings limitation test as quickly as possible is a great idea. It is hard for people to imagine, I guess, that once you have retired you may not have enough money. But, in fact, life goes on and events happen. Sickness comes, unforeseen expenses come, inflation comes, and suddenly you do not have enough dollars to meet your needs. Then you discover if you go back to work that you are penalized for working, you are paying a prohibitive tax rate, more than anybody else in the country, and the bargain that was made with regard to your Social Security is, in fact, being reneged on because you are not getting the Social Security payment that you are entitled to from the withholding of all those payroll taxes throughout your productive years. You find you have to go back to work and you are working at a disadvantage. Revising the earnings limit seems to me to be a question of common sense and fair play, and one, as I have heard other testimony just sitting at this table today, that we know that there is a body of influence that wants to correct rather quickly.

The second area, the repeals of what we call the new tax on Social Security concerns the taxation of that part of Social Security above 50 percent up to 85 percent of benefits that has been referred to frequently in testimony and much discussed. I think that it is very imperative that we get on with that repeal. Again, it is a question of fair play on this, and I do not see how we get away with justifying taxing the seniors. If we are going to have taxes across the board because we need revenues in this country, that is one thing, but why are we picking only on seniors?

I would suggest, as I have many times previously, Mr. Chairman, as you know, and I have been very specific about it with specific lists of spending cuts that I have submitted to this committee and to others over the years, that I think we should focus on spending cuts first. But I also feel that the tax relief in this package for our senior citizens is important, because we have unfairly picked on them.

The part of my testimony that has been amended is the part that has to deal with what happens to the revenues that come in from the Social Security tax. I understand that those revenues in fact, now go to the Medicare Trust Fund. But in effect, they come out of the Social Security Trust Fund system and go into another system, which is not the same part. It is not the same system. They are not going into the General Treasury, which would be worse, but they still are not part of the bargain that was made with the people paying the payroll tax under Social Security. I think that is an area that needs correction.

The final area that comes under the jurisdiction of this committee that is in the packet has to do with long-term care insurance. Obviously, we have taken a good deal of time trying to find out what people's druthers are in the area of health insurance, having gone through the debate last year. I find that perhaps 80 percent of our senior citizens who have health care problems would rather have them taken care of in a home style atmosphere. They would like to minimize expenses.

There are a number of ways that these things can be done through the incentives and the changes in the tax programs that we have outlined here under the long-term care insurance provisions. They will benefit seniors, and will certainly help them get on with dealing with their health care costs. Certainly health reform is an unfinished piece of business for the U.S. Congress, and I think these long-term care provisions will provide welcome relief in the short term.

The other area, the Fair Housing Act, is not in your jurisdiction, but I think it is equally worthy and a much welcomed provision in that act. Mr. Chairman, I would ask that this committee move as rapidly as it prudently can in the areas that are within your jurisdiction because I know our country is waiting eagerly for these changes. I thank you for the opportunity to present this testimony.

[The prepared statement follows:]

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STATEMENT OF CONGRESSMAN PORTER J. GOSS
BEFORE
THE HOUSE WAYS & MEANS COMMITTEE
CONCERNING
"THE SENIOR CITIZENS' EQUITY ACT"

January 10, 1995

THANK YOU MR. CHAIRMAN. I GREATLY APPRECIATE THE OPPORTUNITY TO TESTIFY BEFORE THIS DISTINGUISHED PANEL TODAY. FIRST, LET ME CONGRATULATE YOU ON ASSUMING THE CHAIR AND FOR MOVING SO QUICKLY ON THESE HEARINGS. AND LET ME ALSO CONGRATULATE AND WELCOME ALL THE NEW MEMBERS OF YOUR COMMITTEE. WITH THAT SAID, MR. CHAIRMAN, I'D LIKE TO ADDRESS ONE ITEM IN THE "CONTRACT WITH AMERICA" THAT IS VERY CLOSE TO MY HEART -- "THE SENIOR CITIZENS' EQUITY ACT."

AS YOU KNOW MR. CHAIRMAN, BECAUSE OF THE LARGE NUMBER OF RETIREES WHO RESIDE IN MY DISTRICT, I HAVE WORKED TIRELESSLY ON MANY SENIORS' ISSUES SINCE COMING TO THE CONGRESS. LAST YEAR I WAS ONE OF SEVERAL MEMBERS WHO HELPED DEVELOP "THE SENIOR CITIZENS' EQUITY ACT" AND FOUGHT FOR ITS INCLUSION IN THE CONTRACT. NEEDLESS TO SAY, I AM THRILLED THAT NOW, WE WILL FINALLY BE GIVEN THE CHANCE TO REEXAMINE, LEGISLATIVELY, IMPORTANT ISSUES LIKE THE SOCIAL SECURITY EARNINGS LIMIT AND THE REPEAL OF THE CLINTON SOCIAL SECURITY TAX. I HOPE MY TESTIMONY CAN HELP THE PANEL BETTER APPRECIATE THE HUMAN CONSEQUENCES OF SOME OF THESE CURRENT POLICIES -- AND ULTIMATELY HELP CONVINCE THE HOUSE THAT RAPID ENACTMENT OF THE "SENIOR CITIZENS' EQUITY ACT" IS IN **AMERICA'S** BEST INTEREST.

THE "SENIOR CITIZENS' EQUITY ACT" CONSISTS OF FOUR PRIMARY PROVISIONS -- RAISING OF THE SOCIAL SECURITY EARNINGS LIMIT, REPEAL OF THE NEW TAX ON SOCIAL SECURITY BENEFITS LEVIED AS A PART OF PRESIDENT CLINTON'S 1993 RECONCILIATION BILL, CREATION OF NEW TAX INCENTIVES FOR THE PURCHASE OF PRIVATE LONG-TERM CARE INSURANCE, AND A STATUTORY CLARIFICATION OF THE FAIR HOUSING ACT'S SENIOR COMMUNITY EXEMPTION. THE FIRST THREE FALL WITHIN THIS COMMITTEE'S JURISDICTION. AS ONE WHO HAS SEEN FIRSTHAND THE ILL-EFFECTS ON OUR CURRENT POLICIES IN THESE AREAS, I URGE YOU TO TAKE THIS OPPORTUNITY TO IMPROVE UPON THE STATUS QUO.

FIRST, I WOULD CONTEND THAT REPEALING THE SOCIAL SECURITY EARNINGS LIMITATION IS AMONG THE MOST IMPORTANT ITEMS IN THE ENTIRE CONTRACT. THE CURRENT POLICY DISCOURAGES AND PENALIZES **WORK**, AND HURTS THOSE SENIORS WHO STRUGGLE TO LIVE ON MODEST FIXED INCOMES THE MOST. IN SHORT, THE CURRENT POLICY IS A CRUEL CATCH-22. BECAUSE THE POLICY ONLY WITHHOLDS SOCIAL SECURITY BENEFITS AS **EARNED** INCOME EXCEEDS THE ALLOWABLE MAXIMUM, WEALTHIER RECIPIENTS WHO MAY DRAW UPON PRIVATE PENSIONS OR INVESTMENT INCOME ARE NOT EFFECTED. INSTEAD, IT'S THOSE SENIORS WHO RETIRE AND THEN FIND (FOR WHATEVER REASON) THAT THEIR FIXED RETIREMENT INCOME IS INADEQUATE TO MEET THEIR DAILY NEEDS WHO ARE SUBJECTED TO THE EARNINGS LIMIT. WHEN THEY TRY TO TAKE RESPONSIBILITY FOR THEIR OWN NEEDS, AND RETURN TO WORK, THEY SOON REALIZE THAT EVERY DOLLAR THEY EARN ABOVE THE LIMIT IS TAXED AT AN EFFECTIVE MARGINAL TAX RATE OF NEARLY 60%! NOT ONLY DOES THIS POLICY SERVE AS A DISINCENTIVE TO WORK, IT DEVALUES THE DIGNITY OF INDEPENDENCE.

I FEEL STRONGLY THAT REPEALING THE EARNINGS LIMIT WOULD BE GOOD FOR ALL AMERICANS. NOT ONLY WOULD IT ENABLE WORKING CLASS SENIORS TO REGAIN THE DIGNITY THAT ACCOMPANIES SELF-RELIANCE, THE ENTIRE AMERICAN ECONOMY WOULD BENEFIT FROM THE CONTINUED PRODUCTIVITY OF OLDER AMERICANS. AMERICA WAS BUILT ON THE PRINCIPLES OF INDIVIDUAL FREEDOM AND RESPONSIBILITY. AS WE SEEK TO ROLL BACK THE CULTURE OF DEPENDENCY THAT SEEMS TO HAVE SURROUNDED SO MANY OF OUR FEDERAL PROGRAMS, WE SHOULD ENCOURAGE AND REWARD PRODUCTIVITY AND PERSONAL RESPONSIBILITY FROM ALL AMERICANS. REPEALING THE EARNINGS LIMIT IS A GOOD PLACE TO START.

THE SECOND TAX-RELATED PROVISION IN THE "SENIOR CITIZENS' EQUITY ACT" IS THE REPEAL OF THE ADDITIONAL TAX ON SOCIAL SECURITY BENEFITS. THIS

TAX HAS BEEN VIGOROUSLY DEFENDED BY PRESIDENT CLINTON AND OTHERS IN THE DEMOCRATIC LEADERSHIP AS A NECESSARY AND JUSTIFIED SACRIFICE, IMPOSED ONLY ON THE RICH. IN MY VIEW THIS POLICY IS JUST ANOTHER VESTIGE OF THE OLD TAX AND SPEND MENTALITY. IF WE ARE TRULY GOING TO REINVIGORATE AMERICA, AND MAKE THE SYSTEM WORK FOR THOSE WHO WORK HARD AND PLAY BY THE RULES, THIS IS THE VERY KIND OF POLICY THAT WE MUST RETHINK.

THIS NEW $30 BILLION TAX IS NOT A LEVY ON THE RICH, BUT SIMPLY ANOTHER OF THE GROWING TAXES ON MIDDLE-INCOME AMERICANS WHICH ARE ESSENTIAL TO THE FINANCING OF THE OLD BLOATED FEDERAL BUREAUCRACY. THE POLICY, WHICH MAKES 85% OF SOCIAL SECURITY BENEFITS TAXABLE INCOME, EFFECTS THOSE SENIORS WITH INCOMES OF $34,000 OR MORE A YEAR. I WOULD CONTEND THAT $34,000 A YEAR IS HARDLY RICH BY MOST AMERICANS' STANDARDS -- ESPECIALLY WHEN YOU CONSIDER THE HIGH COSTS OF LIVING SENIORS FACE WITH TODAY'S HEALTH SYSTEM. BY DESIGN, THIS THRESHOLD IS NOT INDEXED FOR INFLATION -- IT WILL BE RATCHETED DOWN IN REAL TERMS OVER THE YEARS.

NOW THAT WE KNOW WHAT IT IS, I'D LIKE TO SUGGEST TWO REASONS WHY IT SHOULD BE REPEALED. FIRST, THIS POLICY CAN BE SEEN AS DOUBLE TAXATION. RECIPIENTS PAYING INTO THE SOCIAL SECURITY SYSTEM HAVE ALREADY PAID INCOME TAX ON THEIR CONTRIBUTIONS. THE OLD POLICY OF TAXING 50% OF BENEFITS RECOGNIZED THIS FACT IN THAT ONLY THE PORTION OF BENEFITS ATTRIBUTABLE TO EMPLOYER CONTRIBUTIONS WAS TAXABLE. SECONDLY, AND MORE IMPORTANTLY, I THINK SPECIFICALLY TAXING SENIORS WHO HAVE RESPONSIBLY PREPARED FOR THEIR OWN RETIREMENTS TO MAKE UP FOR CONGRESS' OWN LACK FISCAL RESPONSIBILITY, IS BOTH MORALLY SUSPECT AND ECONOMICALLY DESTRUCTIVE.

AGAIN, THIS POLICY PENALIZES PRIVATE SAVINGS AND PERSONAL RESPONSIBILITY, ALL TO HELP FUND THE IRREPRESSIBLE GROWTH OF OUR INCREASINGLY INEFFECTIVE FEDERAL BUREAUCRACY. CONTRARY TO SOME BELIEFS, REVENUES GENERATED FROM THIS POLICY WERE NOT DEDICATED TO SHORING UP THE SOCIAL SECURITY TRUST FUND, BUT WERE INSTEAD USED TO HELP FINANCE THE NEW SPENDING INCLUDED IN THE CLINTON BUDGET. THIS UNPRECEDENTED COMMINGLING OF SOCIAL SECURITY RELATED REVENUES WITH GENERAL TREASURY RECEIPTS HAS BEEN WIDELY CRITICIZED. I THINK IT COULD INVITE OTHER FISCALLY INAPPROPRIATE FINANCING ARRANGEMENTS AND FURTHER MUDDLE THE PUBLIC'S UNDERSTANDING AND CONFIDENCE IN OUR ENTITLEMENT PROGRAMS. MOST IMPORTANTLY THOUGH, THIS POLICY AGAIN DISCOUNTS THE PRINCIPLE OF SELF RELIANCE. WE SHOULD ENCOURAGE AND REWARD PEOPLE WHO HAVE HAD THE DISCIPLINE AND FORESIGHT TO SECURE RETIREMENT INCOMES TO SUPPLEMENT SOCIAL SECURITY. THIS SHOULD BE ESPECIALLY TRUE NOW THAT THE FUTURE FINANCING STREAMS OF MANY ENTITLEMENT PROGRAMS THAT SERVE RETIREES ARE IN LONG-TERM IMBALANCE.

FINALLY, I'D ALSO ENCOURAGE YOUR SUPPORT OF THE LONG-TERM CARE TAX INCENTIVES IN TITLE III. AGAIN, THE IDEA HERE IS TO ENCOURAGE AND REWARD INDIVIDUALS TO APPROPRIATELY PREPARE FOR THEIR OWN FUTURES. WHILE THE EVER-INCREASING COST OF LONG-TERM CARE HAS BEEN EQUALLY DIFFICULT FOR GOVERNMENT AND INDIVIDUAL FAMILIES TO MANAGE, EVERYONE AGREES THAT THE MORE WE SAVE NOW, FOR THE VAST DEMANDS THAT OUR NATION'S DEMOGRAPHICS WILL BRING IN THIS AREA IN THE FUTURE, THE BETTER OFF WE'LL BE. THE TAX INCENTIVES IN THIS BILL WOULD SIGNIFICANTLY INCREASE PRIVATE SAVINGS FOR LONG-TERM CARE AND IN TURN BETTER ENABLE US TO MANAGE THE PROJECTED COSTS OF CARING FOR OUR AGING POPULATION. MUCH LIKE HOW THE EMPLOYER DEDUCTION FOR HEALTH INSURANCE HAS CAUSED THE WORK PLACE TO BECOME THE PRIMARY AND MOST LASTING SOURCE OF MAJOR MEDICAL COVERAGE, SIMILAR TAX INCENTIVES ARE NEEDED FOR LONG-TERM CARE. NOT ONLY WILL THIS APPROACH HELP ENCOURAGE THE DEVELOPMENT OF MANY, COMPETING PRIVATE LONG-TERM CARE OPTIONS, BUT BY REWARDING THOSE WHO SELF-INSURE NOW, IT WILL DRAMATICALLY REDUCE THE COST OF OUR ALREADY OVERBURDENED PUBLIC LONG-TERM CARE PROGRAMS IN THE FUTURE.

FOR ALL OF THESE REASONS, I URGE THIS COMMITTEE TO MAKE ADOPTION OF THE "SENIOR CITIZENS EQUITY ACT" A VERY HIGH PRIORITY FOR THE 104TH CONGRESS. THANK YOU FOR YOUR ATTENTION. AND AGAIN MR. CHAIRMAN, THANK YOU FOR THE INVITATION TO TESTIFY HERE TODAY.

Mr. CRANE. Thank you, Mr. Goss.
And next is Mrs. Lowey.

STATEMENT OF HON. NITA M. LOWEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mrs. LOWEY. Thank you, Mr. Chairman, and I too would like to thank you for giving me the opportunity to testify before you, and I would like to ask permission to revise and extend these remarks and submit them to the committee.

Before I focus on the specific bill which I have already introduced in this term, I want to share my colleague, Porter Goss' comments, with regard to the earnings limitation and long-term care, and, in fact, I have had a couple of very specific incidents in my district where I have joined constituents in their outrage, people on Social Security who find that they have to earn a few more dollars and they find that the inspectors are out there chasing them down like common thieves because they want to earn dollars above what they were appropriately supposed to be doing. I think it is urgent that we revise those limitations.

Congressman Nadler and I are here today to encourage you to move forward quickly on your pledge to repeal the increase in the portion of Social Security benefits subjected to taxation from 50 to 85 percent. As you well know, 50 percent was the threshold before passage of the Revenue Reconciliation Act of 1993.

We introduced legislation, referred to by my colleague, H.R. 2987, to repeal this tax increase before the ink was even dry on the enacting legislation. Therefore, we call on you to repeal this onerous tax increase now, eliminating your proposal to phase out the tax over 5 years. The senior citizens who are bearing this burden deserve no less.

The increased taxation of Social Security benefits on those individuals whose incomes are above $34,000 and couples with incomes above $44,000 was wrong when it was enacted and it remains wrong today. There is absolutely no reason to delay its repeal, especially since there are numerous places where cuts can be made in appropriations. In fact, in our bill, which was introduced on August 6, 1993, we explicitly included, in title II of the bill, 10 specific spending cuts totaling $32 billion over 5 years that would have fully offset the revenue loss from repealing this onerous and unfair tax increase. As a member of the Committee on Appropriations, I am prepared to work with you and others long and hard to ensure that we have a serious contribution to deficit reduction through specific spending reductions. The first installment of these reductions should be used to offset repeal of this particular tax increase.

In closing, let me make one point, which I know Congressman Nadler shares and that has to do with the general issue of relative impact of tax laws on residents of high-cost areas, like those we represent in metropolitan New York City. I know in some parts of America, $44,000, at which point retired couples are subjected to this high percentage of Social Security income being taxed, seems like relative affluence. But—let me tell you in the New York metropolitan area, where the average rent on a one bedroom apartment is $1,032 per month, and other costs are also higher than in many parts of the country, people with incomes at these levels hardly feel wealthy, and they do need tax relief.

As my colleague, Porter Goss, referred to his constituents, I hear about this all the time, be it on Queens Boulevard or other parts of my district. People do not feel rich at those income levels.

So, again, we are here today to encourage you to move forward quickly to repeal this tax increase and to make the necessary offsets so as not to increase the Federal deficit. It can be done, it should be done. A phaseout is not good enough and the new tax was imposed without a phase-in. It can and should be repealed without a phaseout. And I thank you very much for your time.

Mr. CRANE. I thank you for your testimony, all of you, and would like at this point, before we start the next panel, to ask members here, do any of you have questions for the preceding witnesses?

Mr. RANGEL. Mr. Chairman, I would like to take this time to thank this panel, and also to ask them to constantly assist us as we attempt to end up with some type of bipartisan agreement on this committee.

I think what you have said, Mrs. Lowey, is very important, and that is that the Appropriations Committee will have to guide the taxwriting committee as to what we end up with, what priorities we place on the savings.

I don't know, but I am inclined to believe a lot of those savings will have to do with the formulas we adopt as relates to pricing out the tax cuts. So it is very important that we continue to work together to see what we can salvage out of this Contract. Thank you.

Mrs. LOWEY. Thank you.

Mr. CRANE. Mr. Ford.

Mr. FORD. Mr. Chairman, I want to thank all my colleagues for their testimony before the committee today, and I guess echo what my friend and colleague on the committee, Mr. Rangel, has said to the Members, is that we are going to be looking forward to working with all of you as we go through this process.

Mr. CRANE. Well, again, I thank all of you who testified thus far, and I appreciate your input. At this point I would like to invite our other colleagues to come on up to the dais so we can start with the next panel.

Well, we have an unwritten rule here on the committee and that is ladies first. So Ms. Norton, you might proceed initially and then we will go to Ms. Woolsey.

STATEMENT OF HON. ELEANOR HOLMES NORTON, A DELEGATE IN CONGRESS FROM THE DISTRICT OF COLUMBIA

Ms. NORTON. Thank you very much, Mr. Chairman, I am here to testify on the aspect of the Contract that has to do with welfare reform. I am here to make constructive suggestions that I hope will improve where we are, rather than to make counterproposals.

I recognize that the Speaker yesterday seemed to wash his hands of the entire business, indicating that perhaps all these things should go back to the States and, therefore, we are done with it. If, however, one-size-fits-all welfare is wrong, so, surely, is the total collapse of all Federal standards that throw defenseless children to be buttressed by whatever State whims come along.

I would like to simply suggest some propositions with the view in mind that these notions can help welfare reform to survive a reality test. First of all, let me indicate where I am coming from. I don't think the State has an obligation to support able-bodied adults, period. We only have welfare because of the State's in loco parentis role in its responsibility for children. Even the majority of welfare recipients say that welfare recipients ought to work, even if they do not like their job. I think we have broad consensus in the country on that.

The predicate of the Contract bill is, of course, jobs. Indeed, that is the be-all, end-all of the bill. I invite the committee to look at the job situation in the parts of the country which have given the greatest concern and perhaps produced this bill: Rural communities and inner cities.

What you have there, Mr. Chairman, is a situation where jobs simply do not exist. And my challenge to the committee is to describe how we are going to have welfare reform in those sections if there are no jobs. I cite the big city unemployment rates for the last 5 years. I cite the tragic black unemployment rates for the last 5 years. I cite the rates for African-American women, who have taken a decline in wages that is horrendous. And I have to ask myself, as I ask you, where is a living wage going to come from after 2 years of looking for a job if you cannot find one?

Look for one and have a public service job, you must, but my question to the committee is, then what? I have looked everywhere in Anacostia. I have looked everywhere in Harlem and I have looked everywhere on the South Side, and I still can't find a job because the welfare rates in my community are 30 and 40 percent. What then is your answer?

My recommendation to you is to listen to your Governors. They said that one-size-fits-all welfare is no good for the States. I say to you, one-size-fits-all welfare is no good for welfare recipients because they range from college graduates to people who are functionally illiterate.

I say to you also that there are different wage and unemployment rates across the country and your 2-year limit has to take into account that factor or else this is not about welfare reform remedied by jobs but is about simply throwing people off welfare who are doing the best they can.

Finally, let me suggest where we might look. The job growth in this country over the past several years has been in temporary jobs and part-time jobs. I believe that the committee might well want to look at part-time jobs. A quarter of the recent growth has been in part-time jobs. In a real sense, if you think about it, part-time work fits with the needs of many welfare recipients. They have young children. They have poor skills. Even if it were necessary to supplement them in a part-time job, it means that they have a job, they are getting a work history. And this is the only way that you can get to permanent employment.

The way most people learn or are trained is on the job. So I say, get these people into the work force. If you have to give part of the grant so that they keep the part-time job, do that.

I leave you finally with the notion that I think there are two very important tests if any welfare reform bill is to survive, and one is minimum national standards. I don't see how anybody can disagree that there ought to be minimum standards. We can fight about how minimum they ought to be but surely there should be some minimum standards. And finally, if the reform bill does not survive the test of practicality, in light of job availability, then, of course, it is not a reform bill at all. It is a tragic ruse.

I thank you very kindly.

[The prepared statement and attachments follow:]

TESTIMONY OF CONGRESSWOMAN ELEANOR HOLMES NORTON
BEFORE THE COMMITTEE ON WAYS AND MEANS
ON THE CONTRACT WITH AMERICA

JANUARY 10, 1995

I appreciate the opportunity to appear here today to testify on perhaps the only part of the Republican contract that is widely familiar to Americans and broadly endorsed by them. Welfare reform as an idea is endorsed by the American public and was the number one concern in exit polls on election day. At the same time, Americans also favor training and work for welfare recipients rather than total cut off of children and mothers working in public service jobs or in compliance with the appropriate rules -- positions directly at odds with the Contract proposals.

Welfare reform has displaced other domestic issues, often because of misconceptions, such as the perception of many Americans that welfare accounts for at least half of federal spending (instead of only 1.1%) or the view of some on the ideological right that destroying welfare as a concept and a program is the answer to illegitimacy. Whatever one's reasons, or party, or social class or racial background, however, welfare belongs at the center of our country's concerns.

Welfare is now and has long been the government mission that has defied reform largely because it is not a single problem. Its content includes a virtual line-up of the country's most serious social and economic problems. Among the most severe are the decline of low-skill, high-wage jobs; the growth in the percentage of children of divorced and out-of-wedlock parents; and the isolation and decline of inner cities and rural communities accompanied by joblessness and social disintegration. The complexity of welfare reform will not yield to the now-you-see-it- now-you-don't - solutions tossed about by many who endorse the Contract proposals.

For the purpose of simplicity, I would like to make my points by offering three sets of propositions. The value of this approach for those in search of bipartisan, practical solutions is that it will allow us to see the points of departure and what I believe are many points of agreement.

First, I lay out my underlying assumptions about welfare reform; second, a set of propositions that point up existing barriers that I believe most Americans would agree must be overcome for welfare reform to succeed; and third, a set of recommendations designed to overcome the barriers in a way that is not inconsistent with the Contract goal of reducing the welfare rolls.

I

First, my underlying assumptions:

1. Parents have the obligation to support their own children.

2. The government does not have a responsibility to support able-bodied people and offers stipends to parents only as a safety-net until they find work and only because of the states's *in loco parentis* obligation to see to the welfare of minor children.

3. Able-bodied parents without the means of support, like other parents, have the obligation to take available jobs, even if they are not the jobs they prefer.

4. A poll of welfare clients in representative cities found that in percentages that ranged from 57.5% to 69.6%, welfare clients believe that "it is wrong to stay on welfare if you can get a job, even a job you don't like."

5. The government has an obligation to convert from its passive welfare check

role, and become an active participant in assisting clients to locate jobs, as it does with people who have unemployment insurance.

6. Because of its ultimate responsibility for minor children, the government must not abandon the safety net when the reason the parent cannot support her child is the absence of jobs and not an unwillingness to work.

7. It is less expensive in actual dollars and less costly to society to require a parent to work for welfare until a permanent job can be found than to leave her destitute without a job.

8. Since without help, 70% of recipients leave welfare in less than two years, the causes for the return to the rolls must be determined, or today's attempt at reform will fail as previous attempts have.

9. If it is impossible for a poor parent on welfare to work without childcare, support must be provided, but if provided only long enough to get the person safely off the rolls, the primary job mission of welfare reform will be undone.

10. Since the least expensive way to provide for the welfare of poor children is the present method of providing a minimal welfare check, it follows that any other approach to welfare reform will increase costs for some years.

11. Aggressive pregnancy prevention, especially for teenagers, is an indispensable element of welfare reform.

II

My second set of propositions points up some of the barriers inherent in the Contract approach to welfare that must be overcome if we are serious and have any hope of reaching those who have invited the most concern, particularly recipients who reside in inner cities and in rural communities, where often the majority of children are growing up on welfare.

1. The most serious economic change affecting the workforce of the 80's and 90's has been a severe and rapid decline in wages and employment among the 75% who are non-college educated men and women.

2. The deterioration in the labor market status of non-college educated Americans has been marked, especially among men and younger workers, despite the economic growth of much of the 1980's as well as the present recovery.

3. Labor market trends for non-college educated men and women in the work force operate profoundly against those who, like many welfare recipients and inner city men, have never been in the work force.

4. Unemployment rates and wage reductions are even greater for young males than for young females, a major factor in the growth of fatherless families.

5. Taken as a group across all income lines, women's wages have fallen deeply since 1970, a situation which forecasts little opportunity for untrained welfare recipients to earn a living wage.

6. Young women with a high school education or less have experienced a steep decline in wages, African American women the most serious of all, with a wage fall of 20%

7. The unemployment rates in large cities establish the great difficulty welfare recipients will have entering the labor force inasmuch as city residents who have a

work history are now and for many years have had high unemployment rates, even without counting welfare recipients, most of whom do not have an attachment to the labor force. See Appendix.

8. The unemployment rate of blacks who were in the workforce between 1990 and 1994 has ranged between 11.3% and 14.1%.

9. Typical of large cities where many welfare recipients reside, the District of Columbia unemployment rate rose in November while the national and Washington Metropolitan rates fell.

10. Because blacks, at 38%, are disproportionately recipients of welfare, the persistently high unemployment rates among blacks who have a work history establish the great difficulty that black welfare recipients will have entering the labor force.

11. Typical of the mismatch between the desire of welfare recipients to work and the availability of jobs is the recent report that more than 900 public housing residents in the District, almost all of them women, applied for 75 trainee constructions jobs.

III

My third set of propositions consists not of a counter proposal to the Contract, but of suggestions designed to make the Contract proposals more than temporary or failed measures.

1. If one accepts the notion that one-size-fits-all welfare does not work for the states, it follows that one-size-fits-all welfare solutions will not work for 10 million women on welfare.

2. To be workable, welfare reform must take account of critical differences among recipients, including whether they live in high or low unemployment areas, high or low wage areas, and whether they are well or poorly educated.

3. To be workable, the two-year-time limit for recipients in compliance with their own "contract" must leave room for adjustments based on the availability of jobs.

4. The most important goals of welfare reform are: (a) for those who are at risk, to prevent and discourage welfare dependency, and (b) for those who are receiving welfare, (i) to encourage and require the goal of self support; (ii) to encourage family stability and continuity; and (iii) to break the present cycle whereby recipients, have been able, without help, to find their own routes off the welfare rolls in less than two years only to return because of loss of a job or indispensable support system, or both.

5. In order to encourage family stability and continuity, as well as an appropriate incentive to self-sufficiency, minors who live with a parent, family member or responsible adult should be eligible for all or part of a grant if the minor continues in school and makes satisfactory progress toward obtaining a high school diploma.

6. Since the most valuable training occurs on the job, a primary goal of reform should be to help recipients obtain a job in the private sector, even if part of the welfare grant must be used as a supplement in order for the job to be self supporting.

7. The best hope of matching welfare recipients with private sector jobs is to track where the job growth is - in part time and temporary jobs.

8. Temporary jobs, which accounted for the largest percentage of new jobs in

1991-1993 (27% though they are less than 2% of the total jobs) are better than no job but may not fully meet the goal of permanently reducing the welfare rolls.

9. Part-time jobs, which account for almost as much of the job growth as temporary jobs (25.9%), are more stable than temporary help jobs, more likely to meet the job skills and needs of many welfare recipients, and should be supplemented, if necessary, because they fill the indispensable role of helping the recipient gain work experience and a work history that can lead to permanent independence.

Mr. Chairman, I thank you and this committee for the opportunity to offer my views.

Geographic Profile of Employment and Unemployment, 1993

U.S. Department of Labor
Robert B. Reich, Secretary

Bureau of Labor Statistics
Katharine G. Abraham, Commissoner

September 1994

Bulletin 2446

Table 23. Selected metropolitan areas and cities: Civilian labor force participation rates, employment-population ratios, and unemployment rates by sex, age, race, Hispanic origin, and marital status, 1993 annual averages—Continued

Area and population group	Civilian labor force participation rate	Employment-population ratio	Unemployment	
			Rate	Error range of rate[1]
Cleveland central city				
Total	56.8	50.6	10.9	8.9 - 12.9
Men	66.5	58.2	12.4	9.6 - 15.3
Women	48.4	44.1	9.0	6.2 - 11.6
White	63.5	58.5	8.2	4.1 - 8.9
Men	75.6	70.4	6.8	3.9 - 9.7
Women	52.6	49.7	5.4	2.4 - 8.5
Black	48.9	40.0	18.2	14.4 - 22.0
Men	55.1	42.7	22.6	17.1 - 28.1
Women	43.6	37.6	13.8	8.7 - 18.8
Single (never married)	57.0	48.2	15.4	11.5 - 19.2
Married, spouse present	67.3	61.6	8.5	5.8 - 11.1
Other marital status[2]	40.8	37.0	9.4	5.1 - 13.7
Dallas central city				
Total	73.1	66.1	9.6	8.2 - 11.0
Men	82.9	75.6	8.8	7.0 - 10.6
Women	63.8	57.0	10.6	8.5 - 12.7
White	74.6	70.5	5.5	4.1 - 6.9
Men	84.9	80.2	5.5	3.6 - 7.4
Women	64.8	61.2	5.5	3.4 - 7.6
Black	71.6	59.4	17.1	14.1 - 20.1
Men	78.5	65.3	16.6	12.3 - 20.8
Women	66.1	54.4	17.8	13.4 - 21.8
Hispanic origin	75.3	69.2	8.1	5.5 - 10.6
Men	88.0	83.2	6.6	3.6 - 9.5
Single (never married)	77.6	67.1	13.4	10.9 - 16.9
Married, spouse present	70.3	66.3	5.8	4.0 - 7.6
Other marital status[2]	71.6	64.2	10.2	7.4 - 13.0
Detroit central city				
Total	53.4	46.1	13.7	12.2 - 15.2
Men	62.5	53.5	14.5	12.4 - 16.6
Women	46.1	40.1	12.9	10.8 - 15.0
White	47.3	43.3	8.3	5.2 - 11.5
Men	59.1	55.5	6.2	2.6 - 9.8
Black	54.9	46.7	15.0	13.3 - 16.7
Men	62.7	52.2	16.8	14.3 - 19.3
Women	48.8	42.3	13.2	10.9 - 15.5
Single (never married)	60.0	46.7	22.2	19.7 - 24.7
Married, spouse present	55.5	52.7	5.1	3.3 - 6.8
Other marital status[2]	41.6	37.7	9.8	7.0 - 12.7
District of Columbia				
Total	66.9	61.2	8.5	7.7 - 9.3
Men	73.1	66.8	8.6	7.4 - 9.7
Women	61.6	56.3	8.4	7.3 - 9.6
White	79.2	76.0	4.1	3.2 - 6.0
Men	85.9	82.3	4.2	2.9 - 5.5
Women	72.8	70.0	3.9	2.6 - 5.2
Black	59.2	52.0	12.2	11.0 - 13.5
Men	64.6	56.7	12.5	10.7 - 14.3
Women	54.8	48.2	11.9	10.2 - 13.7
Hispanic origin	79.4	72.7	8.4	5.2 - 11.7
Men	88.8	80.6	9.2	4.5 - 13.9
Women	71.4	66.0	7.6	3.1 - 12.1
Single (never married)	71.1	63.1	11.2	9.9 - 12.6
Married, spouse present	70.4	66.9	4.9	3.6 - 6.1
Other marital status[2]	53.4	49.5	7.2	5.4 - 9.0

See footnotes at end of table.

Table 23. Selected metropolitan areas and cities: Civilian labor force participation rates, employment-population ratios, and unemployment rates by sex, age, race, Hispanic origin, and marital status, 1993 annual averages—Continued

Area and population group	Civilian labor force participation rate	Employment-population ratio	Unemployment	
			Rate	Error range of rate[1]
Houston central city				
Total	69.0	62.6	9.2	8.1 - 10.4
Men	78.3	71.6	8.4	7.0 - 9.9
Women	60.0	53.9	10.2	8.4 - 11.9
White	70.5	66.1	6.3	5.1 - 7.5
Men	81.9	76.9	6.1	4.6 - 7.6
Women	59.0	55.1	6.6	4.8 - 8.5
Black	65.6	53.7	18.1	15.3 - 20.9
Men	67.4	55.3	18.0	14.0 - 22.1
Women	64.0	52.4	18.2	14.3 - 22.0
Hispanic origin	71.4	64.3	9.9	7.5 - 12.4
Men	88.3	81.3	8.0	5.2 - 10.8
Women	52.7	45.5	13.6	8.9 - 18.2
Single (never married)	75.0	64.4	14.1	11.8 - 16.3
Married, spouse present	67.7	63.7	5.8	4.4 - 7.2
Other marital status[2]	63.7	57.5	9.7	7.1 - 12.3
Indianapolis central city				
Total	71.7	67.5	5.8	4.3 - 7.4
Men	76.9	71.7	6.7	4.3 - 9.1
Women	67.5	64.1	5.1	3.0 - 7.1
White	75.5	72.9	3.4	2.0 - 4.9
Men	81.2	78.2	3.6	1.6 - 5.7
Women	70.4	68.2	3.2	1.2 - 5.2
Black	62.1	53.6	13.6	9.1 - 18.1
Single (never married)	68.4	61.1	10.6	6.9 - 14.3
Married, spouse present	75.9	73.7	2.8	1.2 - 4.4
Other marital status[2]	66.5	62.1	6.8	2.9 - 10.6
Los Angeles central city				
Total	64.8	58.4	9.9	9.0 - 10.8
Men	75.4	67.4	10.6	9.4 - 11.8
Women	54.2	49.3	9.0	7.7 - 10.4
Both sexes, 16 to 19 years	38.2	30.3	20.9	14.9 - 26.8
White	66.4	60.1	9.5	8.5 - 10.5
Men	78.0	70.3	9.9	8.6 - 11.2
Women	54.2	49.4	8.8	7.3 - 10.4
Both sexes, 16 to 19 years	41.2	32.8	20.2	13.7 - 26.7
Black	55.1	46.7	15.3	11.9 - 18.6
Men	59.9	48.9	18.3	13.3 - 23.3
Women	51.0	44.8	12.1	7.6 - 16.5
Hispanic origin	65.2	57.9	11.2	9.6 - 12.9
Men	81.4	72.2	11.3	9.3 - 13.3
Women	47.6	42.2	11.2	8.5 - 13.9
Single (never married)	69.5	60.6	12.8	11.2 - 14.5
Married, spouse present	66.0	61.0	7.5	6.4 - 8.7
Other marital status[2]	53.5	47.9	10.4	8.1 - 12.7
Milwaukee central city				
Total	66.9	61.3	8.4	6.6 - 10.2
Men	72.6	65.7	9.8	7.1 - 12.5
Women	61.8	57.5	7.0	4.6 - 9.4
White	71.8	68.2	5.0	3.3 - 6.7
Men	77.1	71.5	7.2	4.5 - 10.0
Women	66.5	64.9	2.4	.6 - 4.2
Black	67.4	48.9	18.2	13.7 - 22.7
Single (never married)	70.6	61.6	12.8	9.7 - 15.9
Married, spouse present	69.3	66.5	4.1	1.9 - 6.2
Other marital status[2]	54.7	50.8	7.1	3.0 - 11.2

See footnotes at end of table.

Table 23. Selected metropolitan areas and cities: Civilian labor force participation rates, employment-population ratios, and unemployment rates by sex, age, race, Hispanic origin, and marital status, 1983 annual averages—Continued

Area and population group	Civilian labor force participation rate	Employment-population ratio	Unemployment: Rate	Unemployment: Error range of rate[1]
New York central city				
Total	55.9	50.2	10.2	9.7 - 10.6
Men	66.7	59.1	11.4	10.7 - 12.1
Women	46.8	42.8	8.7	8.0 - 9.3
Both sexes, 16 to 19 years	23.4	14.9	36.4	34.8 - 38.0
White	54.7	49.9	8.8	8.2 - 9.4
Men	66.6	60.3	9.4	8.6 - 10.2
Women	44.8	41.2	8.0	7.2 - 8.9
Both sexes, 16 to 19 years	28.8	19.0	34.2	31.6 - 36.7
Black	56.5	46.9	13.6	12.6 - 14.6
Men	64.9	54.2	16.5	15.0 - 18.0
Women	49.9	44.6	10.6	9.3 - 11.9
Hispanic origin	50.7	43.4	14.3	13.1 - 15.6
Men	65.2	55.2	15.3	13.6 - 17.0
Women	39.1	34.0	13.1	11.2 - 14.9
Single (never married)	57.2	49.3	13.8	13.0 - 14.7
Married, spouse present	61.3	56.9	7.1	6.5 - 7.6
Other marital status[2]	43.1	38.5	10.6	9.4 - 11.8
Philadelphia central city				
Total	55.1	48.8	11.5	10.2 - 12.8
Men	64.6	56.2	13.0	11.1 - 14.8
Women	47.4	42.7	9.8	8.1 - 11.6
White	57.0	51.6	9.3	7.8 - 10.8
Men	67.9	60.6	10.8	8.6 - 12.9
Women	47.5	43.9	7.6	5.5 - 9.7
Black	52.1	44.1	15.3	12.9 - 17.6
Men	59.6	49.6	16.8	13.3 - 20.2
Women	46.4	40.0	13.8	10.6 - 16.9
Single (never married)	61.6	51.8	16.1	13.8 - 18.5
Married, spouse present	59.4	55.6	6.4	4.9 - 7.8
Other marital status[2]	38.7	33.0	14.9	11.5 - 18.2
Phoenix central city				
Total	71.0	65.5	7.8	6.5 - 9.1
Men	79.6	72.4	9.1	7.2 - 10.8
Women	62.8	59.0	6.2	4.4 - 7.9
White	71.8	66.8	7.0	5.7 - 8.3
Men	80.8	73.9	8.5	6.7 - 10.4
Women	63.2	60.0	5.1	3.4 - 6.8
Hispanic origin	71.9	65.3	9.2	5.9 - 12.6
Men	85.0	76.7	9.7	5.4 - 14.0
Single (never married)	80.7	69.4	14.0	10.9 - 17.1
Married, spouse present	70.5	67.2	4.7	3.3 - 6.2
Other marital status[2]	62.7	57.9	7.7	4.8 - 10.5
St. Louis central city				
Total	54.2	45.6	15.8	12.0 - 19.6
Women	50.7	42.5	16.3	10.9 - 21.6
White	63.1	59.1	6.4	2.7 - 10.0
San Antonio central city				
Total	61.2	56.8	7.2	5.7 - 8.8
Men	69.9	65.0	7.0	4.9 - 9.0
Women	53.3	49.2	7.5	5.2 - 9.9
White	60.1	55.5	7.7	6.0 - 9.3
Men	68.4	63.3	7.5	5.2 - 9.7
Women	52.5	48.3	7.9	5.4 - 10.4
Hispanic origin	59.5	54.4	8.7	6.5 - 11.0
Men	67.9	62.0	8.7	5.6 - 11.7
Women	52.1	47.5	8.8	5.5 - 12.1
Single (never married)	71.1	62.4	12.3	9.1 - 15.6
Married, spouse present	58.4	55.5	4.9	2.9 - 6.9

See footnotes at end of table.

Table 23. Selected metropolitan areas and cities: Civilian labor force participation rates, employment-population ratios, and unemployment rates by sex, age, race, Hispanic origin, and marital status, 1993 annual averages—Continued

Area and population group	Civilian labor force participation rate	Employment-population ratio	Unemployment: Rate	Unemployment: Error range of rate[1]
San Antonio central city—Continued				
Other marital status[2]	65.6	63.0	4.7	2.0 - 7.4
San Diego central city				
Total	63.9	58.4	8.5	7.1 - 10.0
Men	75.0	68.7	8.4	6.4 - 10.4
Women	54.1	49.4	8.7	6.5 - 11.0
White	65.2	59.7	8.4	6.8 - 10.1
Men	76.2	69.9	8.3	6.1 - 10.5
Women	55.1	50.3	8.6	6.1 - 11.1
Hispanic origin	66.8	57.0	14.6	10.8 - 18.6
Men	80.9	68.3	15.6	10.1 - 21.2
Women	55.0	47.7	13.4	7.6 - 19.1
Single (never married)	72.7	64.2	11.7	8.8 - 14.7
Married, spouse present	62.5	58.8	6.0	4.2 - 7.8
Other marital status[2]	54.2	48.8	10.0	6.0 - 14.0
San Francisco central city				
Total	64.0	58.9	7.9	6.2 - 9.6
Men	71.5	66.4	7.1	5.0 - 9.3
Women	56.1	51.1	8.9	6.2 - 11.7
White	64.5	60.6	6.2	4.1 - 8.2
Men	72.2	68.0	5.8	3.3 - 8.3
Women	55.8	52.1	6.7	3.4 - 9.9
Hispanic origin	67.1	60.8	9.3	4.8 - 13.9
Single (never married)	73.7	67.5	8.5	5.7 - 11.2
Married, spouse present	65.2	61.1	6.2	3.9 - 8.6
Other marital status[2]	44.2	39.2	11.4	6.1 - 16.6

[1] Error ranges are calculated at the 90-percent confidence interval, which means that if repeated samples were drawn from the same population and an error range constructed around each sample estimate, in 9 out of 10 cases the true value based on a complete census of the population would be contained within these error ranges.

[2] "Other marital status" includes divorced, widowed, separated, and married with spouse absent.

[3] Data do not reflect the 1993 official U.S. Office of Management and Budget (OMB) definition of the St. Louis Metropolitan Statistical Area (MSA). See appendix C.

NOTE: Data for demographic groups are not shown when they do not meet BLS publication standards of reliability for the particular area based on the sample in that area. See appendix B.

Mr. CRANE. Thank you.
And Ms. Woolsey now.

STATEMENT OF HON. LYNN C. WOOLSEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. WOOLSEY. Thank you, Mr. Chairman, and I commend you and your committee for holding these hearings on the Contract With America, and I thank you for allowing me to speak.

Today, I will focus on welfare reform because I know firsthand exactly what the faults and merits are of the welfare system. Twenty-7 years ago I was a single, working mother with three small children and I needed to go on welfare so that I could get the health care and the child care that my children needed.

Make no mistake, the welfare system is broken. It does not work for recipients or for taxpayers. The question is: How do we make the system work to get families off welfare for good?

My solution is to invest in innovative job training programs, reinvent the welfare office, and revolutionize child support collection. The Republican proposals, on the other hand, get families off welfare by gutting the system, leaving millions of children without support and possibly on the streets.

Fortunately, the new majority is already hinting that its plan to spend $37 billion a year on government-run orphanages will not be pursued. While I am relieved by this decision, the public should not be fooled into thinking that we can live with the Personal Responsibility Act, an act that cuts off welfare benefits for millions of children who, through no fault of their own, are born to young and poor unmarried women.

The act thwarts our efforts to end childhood hunger by slashing funding for crucial programs such as food stamps and school lunches, and the act's inflexible time limits will cast people off the welfare rolls permanently, regardless of whether there are jobs available. These strict time limits will only result in increased poverty, hunger, and homelessness.

The Republican's block grant proposal will reap similar results. While I support the ability of States to experiment with welfare programs, block grants will harm those least able to defend themselves: Poor children, the elderly, and the disabled. Under this proposal, many poor Americans, including working families, no longer will be eligible for the services they desperately need.

Wisconsin is a good case in point here. While the State's workfare program has reduced the welfare rolls, the number of children living in poverty has doubled. Clearly, cutting benefits and perpetuating the cycle of poverty is not the solution. The key to welfare reform is to reduce the need for assistance, not reduce the availability of assistance.

We can start reducing the need for assistance by collecting the over $5 billion in child support that goes unpaid each year. We can further decrease reliance by implementing comprehensive reform that provides for innovative programs that train for jobs that pay a livable wage. We can pass welfare reform but it will not work unless recipients can find jobs they can afford to live on.

We must also reinvent the welfare office by establishing a single convenient location in the community where individual caseworkers work with recipients to ensure they receive the job training and support services, such as child care and health care, needed in order to permanently move into the work force and off welfare forever.

Mr. Chairman, I thank you and the committee for hearing my testimony and I look forward to working with you on welfare reform. My views are important to this debate because they are based on experience, not theory. So I beg the committee not to use poor children in our country as scapegoats but rather invest in their future.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of Representative Lynn Woolsey
Ways and Means Committe Hearing

Chairman Archer, Ranking Member, Mr. Gibbons, I commend you and all of the Members of the Ways and Means Committee for holding these hearings on the Contract with America, and I thank you for allowing me to testify.

Today, I will focus on welfare reform because I know firsthand the faults and merits of our welfare system. You see, 27 years ago, I was a single, working mother who relied on welfare, even though I was employed, so I could give my three small children the health care and child care they needed.

Since it is unclear what the official Republican welfare reform plan is, I will attempt to comment today on both the Contract's Personal Responsibility Act the Majority's latest proposal to terminate crucial poverty programs and replace them with block grants to the states.

Make no mistake, the welfare system is broken. It doesn't work for recipients or for taxpayers. The question is: How do we make the system work to get families off welfare for good?

My solution is to invest in innovative job training programs; reinvent the welfare office; and revolutionize child support collection. The Republican proposals, on the other hand, get families off welfare by gutting the system, leaving millions of children without support and on the streets.

Let's talk about the Personal Responsibility Act first.

Fortunately, the Majority is already hinting that it's plan to spend $37 billion a year on government-run orphanages will not be pursued. While I am relieved by this decision, the public should not be fooled into thinking that it can live with the rest of this legislation, which is equally damaging.

The Personal Responsibility Act cuts off welfare benefits for millions of poor children who, through no fault of their own, are born to young unmarried mothers.

The Act thwarts our efforts to end childhood hunger by slashing funding for crucial programs such as Food Stamps and school lunches.

And, the Act's inflexible time limits will cast people off the welfare rolls permanently, regardless of whether there are jobs available. In my case, despite my job skills, education, and good health, it took me three years to get off welfare. And you know I wasn't lazy. Strict time limits, particularly on individuals that do not have the advantages I had, will only result in increased poverty, hunger, and homelessness.

The Republican's block grant proposal will reap similar results.

While I support the ability of states to experiment with welfare programs, block grants will only harm those least able to defend themselves: poor children, the elderly, and the disabled. Since these block grants will be vulnerable to the Congressional chopping block, pressure to cut them will be strongest in years of recession, a time when more Americans are in need of assistance. Further, under this proposal, poor Americans, including working families, will no longer be automatically eligible for the services they desperately need. Wisconsin is a good case in point. While the state's workfare program has drastically reduced the welfare rolls, the number of children living in poverty has doubled. Clearly, cutting benefits and perpetuating the cycle of poverty is not the solution to the welfare mess.

The key to welfare reform is to reduce the need for assistance, not to the availability of assistance.

We can start reducing the need for assistance millions of families by collecting the $5.1 billion in child support that goes unpaid each year. Chairman Henry Hyde and I will shortly introduce legislation to revolutionize child support collection by federalizing our ineffective state-by-state child support system.

We can further decrease reliance on welfare by implementing my comprehensive welfare reform package, The Working Off Welfare Act, which I will reintroduce this year.

My bill implements innovative programs that provide recipients with training for jobs that pay a livable wage. We can pass welfare reform until we're blue in the face, but it won't solve anything unless recipients can find jobs that they can afford to live on. We must ensure that training programs give people real skills for jobs that are really out there.

My bill also reinvents the welfare office by establishing a single, convenient location in the community where individual caseworkers can work with recipients. This way, we can ensure that recipients receive the job training and support services, such as child care and health care, that they need in order to permanently move into the workforce.

Mr. Chairman, I thank you and the Committee for hearing my testimony, and I look forward to working with each of you on welfare reform. My views are important to this debate because they are based on experience, not theory. Since we are now considering alternatives to the Personal Responsibility Act, I beg the Committee not to use poor children in our country as scapegoats, but rather to invests in their future. I urge you to consider my realistic proposals for getting families off welfare forever.

Mr. CRANE. Thank you, Mrs. Woolsey.
Mr. Sanders.

STATEMENT OF HON. BERNARD SANDERS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VERMONT

Mr. SANDERS. Thank you, very much, Mr. Chairman, for the opportunity to say a few words about the Contract With America.

Let me put this discussion perhaps in a little bit different context than some others have. We know who won the election on November 8 and we know who lost, but it is also important to point out that in that election 62 percent of the American people did not vote; that we in the United States have the lowest voter turnout in the industrialized world. Therefore, the voices of poor people and low-income people in our democratic institutions in America now are not far removed from what they were for blacks in South Africa just a few years ago. They are irrelevant.

People have the right to vote, but look at the two-party system. The fact is they do not vote. It concerns me very much that as a result of that election in which tens of millions of poor people did not participate, they are going to be victimized by policies developed here by those who won which will cause intense pain and suffering for those people.

In economic terms of what is happening in this country, I think many of us do know what is happening, and that is the people on the top, the very richest people are becoming richer. We see the middle class shrinking and the poor becoming poorer. There are significant increases in poverty at the same time as the richest 1 percent of the people in this country own more wealth than the bottom 90 percent.

As Ms. Norton just mentioned, the new jobs being created are very largely part-time, low-wage jobs which have no benefits whatsoever. So within that context wherein many low-income people and poor people have no power, within the context of economic development in which the rich get richer and most everybody else gets poorer, let us analyze what the Contract With America is about.

What the Contract With America prescribes is that at a time when the rich have already received huge tax breaks over the last 15 years, we are going to reward them with more tax breaks by lowering the capital gains tax—73 percent of whose benefits will go to people making $100,000 a year or more.

So we lower taxes for those people who have already enjoyed huge tax benefits and who are the richest people and, on the other hand what else do we do, we say to children in the State of Vermont, in my State, who are in need of food stamps because maybe their families are hungry that we are going to cut back on food stamps for the hungry. We are going to cut back on the WIC program, which in my State has been a very successful program. We are going to cut back on school breakfast programs and school lunch programs.

So after all the big talk this is what it comes down to. We are going to reward the rich for being rich, and we are going to punish the poor for being poor. I don't think that that is what the American people think this country should be doing.

In terms of crime legislation, we all recognize that there is a serious crime problem. But I talk to many police officials in my State and all over this country who understand that you cannot get to the root cause of crime by simply building more jails. We should wake up and smell the coffee. We already have more people per capita in jail than any other industrialized nation on Earth.

The solution to the crime problem is not simply putting more people in jail. We have got to understand the causation of crime. We have to understand that in communities in America where we have a 40 or 50 percent unemployment rate and where kids are dropping out of high school, that the likelihood of those young people ending up in jail is many times higher than young people in middle-class or upper-middle-class communities.

It is beyond my comprehension that at a time when we need more funding for education, more money for drug rehabilitation, more money for the prevention of crime, more money for counseling, more money to keep an eye on those kids who are falling off the track, and who are going to drift into crime, that any serious person would want to cut back on those crime prevention programs.

Essentially, Mr. Chairman, I think a lot of what is in the Contract With America is moving us precisely in the wrong direction. We need to raise the minimum wage and make sure that everybody who works in this country earns a decent wage. That is the only way you can talk about welfare reform.

We need a jobs program. Right here, 2 miles away from here, and in my own State of Vermont there are enormous public infrastructure needs being unaddressed. We have landfills that need work. When we need to expand rail service, it is crazy to cut Amtrak funding. We need to rebuild our physical and human infrastructure, put people to work and create the opportunity for people on welfare to have decent paying jobs rebuilding their communities.

I thank you very much, Mr. Chairman, for the opportunity to say a few words.

[The prepared statement follows:]

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"Contract with Corporate and Wealthy America"
Representative Bernard Sanders
January 10, 1995

In five minutes I cannot do justice to the Contract with America, but I do want to congratulate the authors of the Contract for their Orwellian titles. I think we can begin to set the record straight by renaming the entire package, the Contract with Corporate and Wealthy America.

On November 8th, in an election in which only 38 percent of the people voted, an election in which low income people barely participated, an election dominated by big money, the Republican Party claimed to have won a mandate for massive change. With that so-called mandate, the Republicans in the House are now proposing legislation which, if enacted, would cause intense pain and suffering for tens of millions of Americans, primarily the weakest and the most vulnerable people in our society.

At a time when the gap between the rich and the poor is growing wider, when the United States has the most unequal distribution of wealth in the industrialized world, when 5 million American children go hungry, the Contract proposes lowering taxes on the wealthy and cutting back severely on programs needed by the poor, the elderly and our children.

The first provision of the Contract, The Fiscal Responsibility Act, would better be called, **The Balanced Budget Bait-and-Switch Act.** That would be a more apt title because it accurately reflects what will happen to middle and low-income Americans when they feel the real pain and suffering in store for them.

Little wonder that so many Americans are so angry and cynical toward the federal government. The first tenet of the Republican Contract with America is the ultimate in "feel good", cop-out legislation. It allows Members of Congress to vote now for a balanced budget without specifying any details on how that goal must be met during the next seven years. The authors of this bill should be ashamed of their con job. Every member of this Congress owes it to talk sense to our constituents and not tell them what they want to hear now, only to stick it to them later.

Immediately after the November elections, newly-elected Republican leaders of this Congress assured all of us that they intend to specify the spending cuts "to put the nation on a glide path to a balanced budget in the next 7 years." That promise was quickly jettisoned. Now we are told vote to amend the Constitution now and that it is impossible to stipulate the spending cuts for the seven-year "glide path" to a balanced budget in 2002. These are classic bait-and-switch tactics, unworthy even of snake oil salesman.

The Republican crime bill, or **The Criminal Creation and Prison Jobs Act** is an effort to take the prevention money out of last year's crime bill, so that we can erect more prisons and expand the use of the death penalty. The new GOP crime bill will reduce the amount spent on crime prevention by $5 billion, taking the prevention spending down from 23 percent of last year's crime bill to 6 percent of the new package.

The Contract's welfare reform act, which I like to call **The Hunger and Homelessness Expansion Act**, cuts back food programs to millions of children, seniors and working Americans, including the Food Stamp, WIC, and the school lunch and breakfast programs. The bill slashes child care, affordable housing and assistance to the blind and disabled. It has been estimated that the Republican contract provision to reform welfare could deny helping hands to 5 million children and 2.5 million adults.

The so-called "Job Creation and Wage Enhancement Act" is really just the **Fat Cats' Reward Act.** The cumulated effect of this bill would be Robin Hood in reverse -- taking from the poor to give to the rich. For example, one of the largest corporate perks contained in the Contract, is a provision that would allow many major corporations to once again pay little or nothing in federal income taxes. Republicans have said they intend to wipe out taxes on profits from new investments by allowing an immediate tax write-off for capital outlays. In other words, businesses would be able to deduct considerably more than their actual costs. Costs to American taxpayers for this corporate boon would come to $35-40 billion a year.

This legislation would make about two-thirds of all capital gains tax-exempt. The Joint Committee on Taxation estimates the added costs of these capital gains tax breaks to be $25 billion a year -- mostly for the very rich. The Joint Committee on Taxation has estimated the cost in the second 5-year period of enactment could exceed $160 billion. Almost half of the benefits from the capital gains provisions would go to the wealthiest one percent of the population!

These half-baked revenue proposals will cause both a worsening of the deficit and deep reductions in discretionary social programs. While the deficit has been halved as a share of Gross Domestic Product since 1992, large potential budget savings would have to go to paying for tax cuts rather than continuing to make progress on deficit reduction. Combined with the Contract's proposal to balance the budget, enormous cuts will have to be made in Medicare, Medicaid, and veterans programs. Since the Republican Leadership has said they plan on taking Social Security, interest on the federal debt, and defense spending off the chopping block, we can expect to see even deeper cuts in the other social programs designed to help our most vulnerable citizens.

In short, the Contract with Corporate and Wealthy America will further increase the disparity between the rich and the poor. During the period from 1977 to 1990, the average after-tax income of the richest one percent of American households doubled, while the income of the average American household in the middle fifth rose only three percent. Meanwhile the lowest fifth's income dropped 12 percent. Key tax proposals in the Contract go to those Americans that have seen their wealth double just in the past 15 years. Meanwhile, the main spending cuts specified in the Contract are $40 billion over five years from reductions in AFDC, public housing, nutrition programs and programs that assist the blind, disabled and impoverished.

As Republican strategist, Kevin Phillips has noted about the growing gap between the rich and poor in America, "This stratifying starts to make us into a different country. It goes to the American notion of fairness."

Americans are an intelligent people and a hardworking people. But what has gone on for a number of years is that the power and wealth has gone away from ordinary people and is now in the hands of the very few, and the few are using that power and wealth to enrich themselves, ignoring the needs of the vast majority of ordinary people. That is why so few Americans came out to vote in the last election -- because they no longer feel that government works for them, but rather, for the interests of the wealthy and the powerful. I urge you not to carry out this unfair Contract and to reconsider the needs of ordinary Americans. I and other Progressives intend to bring forth real alternative solutions to the real problems confronting the vast majority of Americans.

Mr. CRANE. Thank you, Mr. Sanders.
Mr. Filner.

STATEMENT OF HON. BOB FILNER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. FILNER. Thank you, Mr. Chairman. My name is Bob Filner. I am in my second term representing San Diego, Calif. I thank you for allowing me to have the opportunity to bring forward a proposal that I think will help ensure tax fairness, restore the American dream, and assure fiscal responsibility.

As a Democrat, I support several of the items in the Contract With America. I am especially enthusiastic about the repeal of the taxes on Social Security benefits contained in the Senior Citizens' Equity Act. But, while others will testify in the coming days in support of middle-class tax cuts and repealing taxes on Social Security benefits, most will not offer any concrete way to pay for these cuts. Mr. Chairman, I am here to offer the committee at least a partial solution, one way to pay for these proposals.

My plan would bring $2 billion annually in new revenue to the U.S. Treasury and would not require a general tax increase. Let me repeat: That is $2 billion per year without a tax increase! All that is required is a technical correction to existing tax laws affecting life insurance companies.

Soon I will reintroduce legislation that I originally wrote in the 103d Congress that would repeal section 809 of the U.S. Federal Tax Code. This provision has failed to achieve the purpose intended by the Ways and Means Committee in 1984—and needs to be corrected. As a result, the U.S. Treasury is losing revenues estimated to be as high as $2 billion per year.

My legislation is simple, and based on a careful examination of previous congressional efforts that have failed to produce the intended results. It will achieve the revenue which Congress and the Treasury intended to be paid by the mutual life insurance industry. If action is not taken, Congress will again forgo collecting this $2 billion in taxes from a few mutual life insurance powerhouses that have familiar household names. Until now, no one seemed to want to examine this glaring loophole in section 809 of the Tax Code due to both its technical and political complexity.

This $2 billion annual windfall dates back to when Congress attempted to correct the taxation of mutual life insurance companies. The corrective action was intended to provide income to the U.S. Treasury based on equity among life insurance companies, whether they be stock or mutual. After a short-term increase in taxes was realized, the revenue actually began to decrease. Four years later, the Treasury and the General Accounting Office admitted something was wrong. The intended revenues were not being generated.

In fact, certain large insurance companies had been paying no taxes on earnings for business activity since 1986. By being able to regulate their sale of assets, the few giant mutual insurance companies were able to increase or decrease their taxes on business activities under the terms of section 809. Obviously, this is contrary to congressional intent.

According to several experts, including those used by the IRS, section 809 should have been generating between $1.5 and $2 billion per year in taxes from these large mutual insurance companies. Since this was not happening, Congress again attempted corrective action. Many of you were here for those hearings in 1989. No results were achieved. The life insurance industry itself was then asked to develop a proposal and bring it to Congress. Six years have passed and Congress is still waiting for that report.

I don't have to tell you that the Nation is in a dire financial situation. We cannot afford to wait any longer. Of all the difficult choices Congress faces, none are more agonizing than those involving taxpayer dollars. The loss of $2 billion in annual revenue makes the choices between military spending, middle-class tax cuts, welfare reform, veterans' programs, and social services even more difficult than they need to be. Closing the section 809 loophole makes a lot of sense, but it is a difficult political decision. Closing it would send a message to the insurance industry that the special interest gravy train has run out of tracks. It would show the Nation that Congress has its priorities back in order.

I thank you, Mr. Chairman, and colleagues, for the opportunity to present this proposal. I hope this committee will hold hearings to discuss this loophole, and I look forward to working together with you to pass this legislation and to helping restore the American dream.

Mr. CRANE. Thank you, very much, for your testimony.

And next is Mr. Franks.

STATEMENT OF HON. BOB FRANKS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. FRANKS. Mr. Chairman, I appreciate the opportunity to testify today in support of a targeted capital gains tax reduction.

Congressman Meehan and I would want to make the members of the committee aware of our modified version of a capital gains tax reduction which tends to focus capital where our economy needs it most, the manufacturing sector.

When I joined Congress in January 1993, I began looking for ways to assist this vital sector of our economy. I was fortunate back then to meet up with Congressman Meehan, who was also a freshman at that time, and together, with the help of the Northeast/Midwest Congressional Coalition, we formed the first-ever bipartisan task force on manufacturing.

During the past 2 years, the task force met with scores of experts, visited literally dozens of manufacturing facilities, and held public forums on the future of manufacturing in Washington, Trenton, Boston, Cleveland, and Detroit. In July, we released our findings and recommendations which were designed to remove the shackles from manufacturers that are currently inhibiting growth, innovation, and job creation.

Although it has been a long recognized fact that a nation's rate of investment is critical to its economic growth, the United States has consistently lagged behind its international competitors in the share of its national output devoted to productive investments in the private sector.

Our current system lacks a crucial component—one that our industrial competitors have long used to gain a competitive edge—incentives to invest.

A change in the Tax Code is essential to encourage investment in America's manufacturing enterprises. Federal law should assist, and not discourage, businesses in raising equity capital to fund growth and expansion.

Repeatedly, during our meetings with manufacturers, especially the small and midsized firms, we were told that these companies often cannot obtain the capital they need to modernize their equipment or expand their production.

In many cases, prospective investors demand a short-term return on their capital, which underscores the fact that there is little patience in capital markets. Most manufacturing operations cannot satisfy a short-term timeframe with any degree of assurance. Because of these conditions, creating greater access to capital has emerged as one of the most pressing goals of our manufacturing task force.

To achieve this objective, our task force recommends a targeted capital gains tax rate reduction to 10 percent for productive assets held for 6 years or longer. The terms of our legislation would fix the rate at 23.5 percent for assets held for at least 3 years.

Our proposal was carefully crafted to avoid abuse. The tax break would be limited to those companies that are classified as domestic producers of manufactured goods and would apply only to those assets that contribute to a manufacturing company's productive output. These assets would have to be held for a minimum of 5 years in order to qualify for any tax break.

The benefits of this tax reduction would be substantial. It would enable entrepreneurs and small manufacturers to raise more equity and to reduce the cost of attracting capital. Also, preferential treatment of capital gains creates incentives for industry and investors to focus on long-term expansion.

With the cold war behind us and the lifting of trade barriers, our Nation faces an enormous new challenge, to become the undisputed economic superpower of the world. It is a race that we can and must win, but some of us in Congress believe that success will come only if we unleash our most potent weapon, our industrial base.

Mr. Chairman, thank you for your consideration of my remarks, and I look forward to working with you and the members of this committee to create a more rational Tax Code, one designed to help and not hinder our Nation's manufacturers.

Mr. CRANE. Thank you, Mr. Franks.

And now, Mr. Meehan.

STATEMENT OF HON. MARTY T. MEEHAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. MEEHAN. Mr. Chairman, thank you for the opportunity to testify before the committee today.

Two years ago Mr. Franks and I launched a Northeast/Midwest Congressional Coalition manufacturing task force because we believed that the United States and global economies are experiencing rapid and fundamental economic change. To effectively compete in this new global economy, we believe that the U.S. workers and companies must have the necessary training and resources available if they are to thrive in the ever-changing economic environment.

Mr. Chairman, there are three actions that Congress can take to increase the chances of success of our workers, managers, and companies in this new technology-driven knowledge intensive world.

First, we need to achieve a balanced budget by continuing to reduce the Federal budget deficit. The Federal Government's continued heavy demands in the global credit market makes it more expensive for private-sector borrowers to raise the capital needed for future growth.

Second, we need to encourage households and businesses to increase their savings so as to expand the funds available for investment in companies and jobs for the future. Most economists believe that 80 percent of a country's investment funds come from its own savings.

Third, if the technologies of the future are to be successfully developed, we need to encourage our workers and companies to take on increased but prudent levels of risk.

Mr. Franks and I believe that to achieve these policy objectives Congress needs to consider making substantial changes in the current tax law. As it is written today, many provisions in the current tax law not only do not encourage savings, investment and risk taking but, in fact, discourage those activities which have resulted in reduced levels of high-wage jobs and slower economic growth.

During the last 2 years we held field hearings to look at several options for what would be the most efficient ways of spurring long-term investment in capital formation. Based on those hearings we concluded that a targeted, carefully crafted capital gains tax rate reduction was the most efficient and that it will result in increased savings, increased investment and increased risk taking and has the potential to increase revenue over the long term.

Our proposal is aimed at investments in manufacturing. We believe this proposal offers several key advantages.

First, a conditioned rate cut based on patient investment will discourage short-term speculative buying and selling of assets, a pattern that runs counter to the capital needs of manufacturers. Such a cut provides an incentive for manufacturers to carry out long-range planning and investments—essential if they are to modernize, develop new product lines or expand production.

Second, it only provides favorable treatment to productive assets. It excludes assets such as art collections, rare antiques, rare coin collections. Tax policy should only be favorable to taxpayers who make an explicit contribution to economic growth and employment.

Finally, the revenue impact. In order to be fiscally responsible we must estimate that all tax cuts carry a cost in terms of forgone revenues and the need to be paid up front. Failure to do so would be irresponsible, and that would certainly balloon the Federal budget deficit.

With that in mind, our proposal is carefully crafted to give a maximum bang for the buck. By targeting the cut to investment in American manufacturing, the legislation provides tax relief to those investors who are willing to make an explicit contribution to increase economic growth and employment. This significantly reduces the fiscal impact of the cut while still achieving the desired objective.

In short, our capital gains tax cut will address the problems of long-term capital availability that the manufacturing sector faces. Targeting the cut to manufacturing investment reduces the cost to the Federal Treasury and will give manufacturers the ability to better plan for and carry out modernization activities which ultimately increase U.S. competitiveness and job creation. Our proposal is also crafted to address the issue of tax fairness by generating and saving jobs, and encouraging spinoff of economic activity.

Thank you, Mr. Chairman, for the opportunity to testify today. I look forward as well to working with members of the committee.

[The prepared statement follows:]

Statement of the Honorable Marty Meehan
5th District of Massachusetts
U.S. House of Representatives

Before the House Ways and Means Committee
January 10, 1995

Mr. Chairman, thank you for the opportunity to testify before the committee today.

Two years ago, Mr. Franks and I launched the Northeast-Midwest Congressional Coalition Manufacturing Task Force because we believe the U.S. and global economies are experiencing rapid and fundamental economic change. To effectively compete in this new global economy, we believe U.S. workers and companies must have the necessary training and resources available if they are to thrive in the ever changing economic environment.

The Fifth District in Massachusetts, my district, is an excellent example of the type of rapid economic change the U.S. economy faces. The Massachusetts Miracle was, in many ways, the result of tremendous worldwide demand for mid-range computer systems that were at the leading edge of technology from the mid-1970s until the mid-1980s. These systems were developed and produced in Massachusetts by such companies as Digital Equipment Corporation, Wang Laboratories and Data General Corporation. However, in the 1990's, these large global systems companies have experienced great difficulty because their products have become technologically obsolete. The result has been the loss of tens of thousands of jobs, tremendous pain for workers and their families and real problems for the Massachusetts economy.

Much of the new technology that made the mid-range computers outdated, is the result of tremendous advances in semiconductor technology that has given us much smaller personal computers. Interestingly enough, large numbers of these small computers are now linked together via local area and wide area networks. Many key components for these networks have been developed and produced by many Massachusetts companies that have risen out of the ashes of the fallen industry leaders. Companies such as Bay Networks, Chipcom and Powersoft are leading the worldwide effort to develop networking technology from their home offices in Massachusetts' Fifth Congressional District. This development activity is a key part of worldwide information technology, including the development of the so-called "information superhighway."

This revival of the Massachusetts economy has been driven by the entrepreneurial spirit and risk-taking attitudes of the worker, managers and owners of a new class of companies. Federal policy should do all that is necessary to create an economic environment in which such companies can adapt, thrive, grow and continue to successfully create new jobs. If the "information superhighway" is to become a reality -- and it is by no means certain -- two ingredients are required; a tremendous capital investment and a desire to take on a high degree of risk.

Mr. Chairman, there are three actions that Congress can take to increase the chances of success of our workers, managers and companies in this new technology driven, knowledge intensive world.

* First, we need to achieve a balanced federal budget by continuing to reduce the

deficit. The federal government's continued heavy demands in the global credit market makes it more expensive for private sector borrowers to raise the capital needed for future growth.

* Second, we need to encourage households and businesses to increase their savings so as to expand the funds available for investment in companies and jobs of the future. Most economists believe that 80% of a country's investment funds comes from its own savings.

* Third, if the technologies of the future are to be successfully developed, we need to encourage our workers and companies to take on increased, but prudent, levels of risk.

Mr. Franks and I believe that to achieve these policy objectives, Congress needs to consider making substantial changes to current tax law. As it is written today, many provisions in current tax law not only do not encourage savings, investment and risk-taking but, in fact, may discourage those activities which have resulted in reduced levels of employment and slower economic growth.

Closing tax loopholes that unfairly enrich one group at the expense of another -- usually lower income groups -- is a worthwhile policy objective. However, as a result of the Tax Reform Act of 1986, current tax law fails to distinguish between those economic activities that are productive and to be encouraged and those that are unproductive and only benefit a wealthy few. It is the productive activity, such as investment in the manufacturing sector, that tax law should encourage.

By shifting the tax burden toward business income and away from personal income, the 1986 act implicitly created incentives in favor of consumption and away from investment. In other words, the act created incentives, ironically, away from building for the future and toward consumption today. In an imperfect world of second best solutions, tax policy that favors investments in productive capital may be a necessary incentive for the manufacturing sector.

During the last two years, the Manufacturing Task Force held field hearings to look at several options for what would be the most efficient means of spurring long term capital formation. Based on those hearings, we concluded that a carefully crafted capital gains rate reduction, was most efficient in that it will result in increases in savings, investment and risk taking and has the potential to increase revenue in the long term.

The Task Force's proposal calls for the establishment of a targeted long term capital gains tax rate cut: to 23.5 percent for productive assets held for three years or longer; for assets held six years or more, the rate would drop to 19 percent. The cut would be aimed at investments in manufacturing. We believe this proposal offers several key advantages.

First, a conditioned rate cut based on patient investment will discourage short-term speculative buying and selling of assets, a pattern that runs counter to the capital needs of manufacturers. Such a cut provides an incentive for manufacturers to carry out long-range planning and investments -- essential if they are to modernize, develop new product lines, or expand production.

Second, it only provides favorable treatment to productive assets, and excludes assets such as art and antiquities. Tax policy should only be more favorable for taxpayers who make an explicit contribution to economic growth and employment.

Third, the two-tiered approach serves as a good middle ground, able to capture the advantages that a capital gains rate cut would have for both spurring investment and encouraging patient capital.

Finally, the revenue impact. In order to be fiscally responsible, it is important to estimate that all tax cuts carry a cost, in terms of foregone revenues, and need to be paid for up front.

Failure to do so would be irresponsible, and would almost certainly balloon the deficit.

With that in mind, the Task Force's proposal is carefully crafted to give a maximum bang for the buck. By targeting the cut to investment in manufacturing, the legislation provides tax relief to those investors that make an explicit contribution to increases in economic growth and employment. This significantly reduces the fiscal impact of the cut while still achieving the desired objective.

In short, the Task Force's capital gains tax proposal will help address the problems of long-term capital availability that the manufacturing sector faces. Targeting the cut to manufacturing investment reduces the cost to the federal Treasury, and will give manufacturers the ability to better plan for and carry out modernization activities, which ultimately increases U.S. competitiveness and job creation. The Task Force proposal is also crafted to address the issue of tax fairness by generating and saving jobs and encouraging the spin-off of economic activity.

Thank you, Mr. Chairman for the opportunity to testify today. I look forward to working with you and the Committee.

Mr. CRANE. Thank you for your testimony, Mr. Meehan.

Are there any members of the committee who have questions or comments to direct to this panel?

Mr. RANGEL. Mr. Chairman.

Mr. CRANE. Yes.

Mr. RANGEL. Ms. Woolsey and Ms. Norton, I am sorry that Representative Sanders has left, but clearly we don't have the votes to make any substantial changes in what the majority is attempting to do with the welfare bill. And clearly popular opinion appears to be on their side because of the frustration that people feel about a system that is not working.

I do think that we have a wonderful opportunity to bring more equity, more job opportunity, more investment in human beings to the board because it is not inconsistent with anything that they believe, even though it is not stressed in the Contract.

Congressman Ford has agreed to head up an ad hoc committee to see whether Members such as yourselves, Mr. Sanders, and others might want to bring their ideas to the table since he doesn't enjoy the luxury of subpoena and holding hearings any longer.

But my question is, am I missing something when I speak about the silence of the churches and the synagogues and the temples on this issue? It just seems to me that there is no spiritual theory that does not concern itself with one's obligation to help those who can least help themselves.

And in New York Cardinal O'Connor spoke out against the mayor cutting off the soup lines, an initiative I might add that was started, and continues, by the nuns as opposed to the priests, but that was headlines in the New York papers, that my cardinal has spoken out to maintain soup lines.

Am I missing something, Congresswoman Norton? Are the churches far more vocal than I think they are?

Ms. NORTON. Mr. Chairman, to its great credit, the Catholic church has spoken out in opposition to major aspects of the bill that is before you. For example, the church is against putting people off welfare who are doing all they can in terms of working, even if it is a public service job.

Mr. RANGEL. It is interesting that you would say that because it is clear that the social service parts of Catholic charity have and continue to do a fantastic job in all of our legislative bodies, especially here in Washington, but they never seem to set the moral tone for fellow Catholics. It seems as though we deal with the mechanics, we deal with the legislation and try to improve it, but where public opinion is involved, I just don't hear the voices of the cardinals throughout this country. I don't mean to single out my church, of course. I am talking about the Board of Rabbis, the Protestant Council and whatever religions are there.

Ms. NORTON. Mr. Chairman, I do believe that this criticism comes from the bishops themselves and not simply from Catholic charities. I believe this is the position of the church.

I believe what we are going to experience is a terrible delayed reaction. When the fallout occurs, everybody is going to come running to the Congress saying, "How could you let this happen"?

That is why my approach has been not to offer a counterproposal, and not to say do it our way. I certainly accept what you have said, that we don't have the votes to do that, but to challenge the committee to make its own proposals work. And I don't think you make your proposals work if you think you are going to get people in Harlem off the welfare rolls in 2 years if there are no jobs.

So you have to think just a little deeper, and one of the ways to do so—and I offered a concrete suggestion—is to allow part-time jobs to serve as supplements to those jobs, for example. But if all you say is you are on your own after 2 years, you are going to have a giant catastrophe and you will have the Catholic church, all the rabbis, every church and lots of Americans coming in and berating us for not having seen in advance that there would be these vast, unintended consequences.

Mr. RANGEL. But—no one challenges the hard work that you are doing, but it is clear that the majority has a contract, they have something. And it is clear that President Clinton at this point has nothing. And you and I are trying to see whether or not we can bring some equity out of what they declare as a mandate.

It would seem to me that if we could meet and to bring public opinion—I mean, one of the solutions offered by the Speaker is Boys Town. Well, you know, I would like to know, who is running Boys Town today? It was a Catholic institution. Do they think it makes any sense at all?

Ms. WOOLSEY. Mr. Rangel.

Mr. RANGEL. But we are going to meet and we would hope that you would entertain meeting because we are going to need more than concrete ideas to shift this program from where it is located today, and we are going to need a lot of help. And I don't think we can wait until there is maximum pain because they are sending enough signals now that they are not taking any prisoners, that popular opinion is with them, and they are going to go ahead and move forward.

So the least we can do is to bring in as many moral forces as we can to do what you are saying, and that is let's take a look at this. Let's see whether it is going to work. And if it can't work, let us make some solutions to reform the system with you.

Thank you so much, both of you, and all of you, of course, but especially in this area.

Mr. CRANE. Are there any other questions by members of the committee?

If not, we thank you all for your testimony.

And at this point I would like to invite up to the dais Mr. Smith of Michigan, Mr. Largent of Oklahoma and Mrs. Roukema from New Jersey. It is our procedure for ladies to go first.

STATEMENT OF HON. MARGE ROUKEMA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mrs. ROUKEMA. Oh, thank you. I accept, Mr. Chairman.

Certainly I wanted to congratulate you and certainly Mr. Archer, the chairman of the full committee, for your well-deserved promotion to the positions that you hold today. As a fellow Republican, I congratulate you and must acknowledge that we in the party and the Congress as a whole have a historic opportunity to demonstrate our commitment to the constructive change that we have pledged. And certainly we are all wanting to work together for a more effective and efficient government, and I certainly thank you for having these hearings and holding them so promptly.

Mr. RANGEL. Mr. Chairman, you should know that she said the same thing to me when I was chairman.

Mrs. ROUKEMA. Did I, Mr. Rangel? You see how right I was. I was right then, and I am right now. Thank you.

Mr. CRANE. Thank you.

Mrs. ROUKEMA. Mr. Chairman, I would suggest that as we are going in this overview on the Contract With America I would like to concentrate my remarks today on the welfare system and that particular part of it as well that deals with child support enforcement.

Unfortunately, this debate has focused, at least in the popular press, almost exclusively on the single issue of orphanages or settlement houses or group homes, youth hostels, whatever you choose to call them, but I suggest that we have to resolve to end this war of words today and that we—Conservatives, Moderates and Liberals alike—must acknowledge that our welfare system is out of control and needs essential reform.

Clearly, what outrages the American taxpayers most completely is the conviction that the welfare system is a failure. Not only is it wasting hard-earned taxpayers' dollars, but it has created and is fostering, in my opinion, unhealthy, unproductive and dysfunctional families that sentence children to a lifetime of extreme economic, social and emotional deprivation.

Clearly, the children are the victims here. In reinventing the welfare system we must address both the short-term and the long-term problems of these children. Youth hostels and group homes—orphanages, if you will—should be an element of reform. But the costs will be significant whether we absorb them at the Federal or at the State level.

Ultimately, however, the Americans and the Congress will not countenance children being raised in abusive, drug-infested households or going hungry in the streets. Therefore, we must begin a serious debate now, not an unproductive war of words.

One aspect of our current welfare system that has attracted a lot of controversy is the fact that welfare recipients can automatically receive additional, higher benefits when they have more children. In some cases, this amounts to a perverse incentive for beneficiaries to remain on welfare and have more children, instead of taking responsibility for them and their families getting off welfare.

A few years ago, the New Jersey State Legislature under the then Democratic Governor and with the cooperation of Republican legislature concluded that the welfare program was simply subsidizing unwed mothers and out-of-wedlock births and that strong corrective action was necessary. The State began denying AFDC benefits for new children in August 1993. The preliminary results for this new initiative during its first 12 months indicate that births to AFDC recipients have been reduced by more than 10 percent. It is too early to precisely determine what caused this reduction, but it is an encouraging sign nonetheless.

On the Federal level, I feel that we must follow this example and prohibit any automatic increase in AFDC benefits to mothers already in the program who have additional children. At the same time, the committee should ensure that women on AFDC who have additional children can earn higher amounts of AFDC benefits by working without jeopardizing their current benefits. I am sure that will be a central part of the ongoing debate.

For decades, States have required that children entering the school system be properly immunized and vaccinated. Mr. Chairman, I am not going to spend time on this. In the interest of time I am just going to point out that I believe that as preventive medicine it is essential that we put it as a requirement for continuing AFDC benefits that families have their children immunized, using the medical protocol which is within the first 2 years. It is done for school entrance. It has been for generations. I think we should now apply it as a condition for welfare qualifications.

I won't go into the expansion of the JOBS program. It is in my written statement. But I would like to go on to the question of block granting welfare and giving the States more flexibility since that has been in the press lately with respect to the Republican Governors' Conference.

Mr. Chairman, am I already out of time? I haven't gotten to my point on child support enforcement.

Mr. CRANE. Well, continue with your point on child support. And anything in anyone's comments that is not presented, if it is in writing it will become a part of the record, too.

Mrs. ROUKEMA. Let me just summarize the child support enforcement portion of this since that is, I feel, the essential component of any welfare reform bill, and it is one that the U.S. Commission on Child Support, on which I served, their report formed the basis of my recommendations.

I think Congress has been working for more than 10 years on this subject, and it has finally come time for us to enforce and close any existing loopholes that Congress never intended, including the national system, including going in for direct service into States where a willful child support avoider is employed in another State. Now we would like to circumvent that State bureaucracy since they are not being as cooperative as they should be and go direct—with direct service to garnish the wages of the willful violator in the next State.

I believe we have already made a good start on the subject of criminal penalties. We have already established that interstate, and we should now apply it within the State. For willful child support avoidance there should be criminal penalties.

The one area where there has been some discussion and probably not as much controversy as you might have thought was the requirement to establish paternity at the hospital at the time of birth. This was not something that I necessarily would have concluded, but the Commission has concluded that it is an essential component, and that is that if the woman does not cooperate in establishing paternity at birth in the hospital, then she will not qualify for cash support.

I think this is an essential element. It has been shown by the Commission studies that in areas where there have been demonstration projects that it has worked very well. In some cases up to 80 percent of nonmarried parents have been identified as with fathers, and the fathers have been made to accept the personal responsibility for those children, and it has a direct impact on reducing the numbers of families on welfare. Women who do not cooperate under this program would not qualify for welfare.

On the subject of willful child support avoidance, we have the example of a State like Maine where in our legislation we have followed what Maine has done and made withholding of drivers' licenses and other professional licenses a penalty for willful avoidance of child support.

The State of Maine has had a remarkable experience in proving the fact that as soon as there is a penalty involved the money strangely appears, so in this legislation I am recommending that we include that penalty for occupational licenses and withholding drivers' licenses as one of them. It will greatly enhance the collection.

Mr. Chairman, I know we are out of time now, but I want to suggest to you that while we are talking about the Contract With America we recognize that this Contract is well on its way to being accepted. This problem of child support enforcement has long been festering, and there is no need for us to delay any longer. We should take this opportunity for the historic change, the saving of taxpayers' dollars, more efficiency, and by all means we are caring for the children who have suffered the greatest disadvantage. The Contract With America should be the vehicle for this comprehensive child support enforcement reform. No more talk. Now we need action.

[The prepared statement follows:]

Statement of
The Honorable Marge Roukema
before the
House Ways and Means Committee
January 10, 1995

Before starting my testimony, I would first like to congratulate my distinguished colleague from Texas -- Bill Archer -- on his well-deserved promotion to the chair of the House Ways and Means Committee.

Mr. Chairman, you have waited many years for this exciting opportunity and we are all supremely confident that you are up to the task of leading the Committee during the 104th Congress.

Also, I want to thank you, Mr. Chairman, for so quickly organizing the Committee and holding hearings on those legislative measures found in the our "Contract with America".

The people of the United States have given the Republican Party a historic opportunity to demonstrate our commitment to constructive change -- a change to more effective and efficient governance. These hearings represent the first step in what is sure to be a long and difficult process of fulfilling this commitment. I, for one, welcome the challenge.

This hearing has been designated as an "overview" on the "Contract with America." I'd like to begin my testimony by focusing on the urgent need to reform our nation's welfare system.

DSYFUNCTIONAL SYSTEM

Unfortunately, this debate recently has focused almost exclusively on a single issue -- "orphanages" or "settlement houses" or "group homes" or "youth hostels". Whatever you want to call them -- we must resolve to end this "war of words" today. We (conservatives, moderates and liberals alike) must acknowledge that our welfare system is out of control.

Clearly, what outrages American taxpayers most completely is the conviction that the welfare system is an unmitigated failure. Not only is it wasting hard-earned taxpayers dollars, but it has created -- and is fostering -- unhealthy, unproductive dysfunctional families that sentence children to a lifetime of extreme economic, social and emotional deprivation.

Clearly, the children are the victims!!! In re-inventing the welfare system, we must address the short-term and long-term problems of the children. Youth hostels and group homes (orphanages if you will) should be an element of reform. But the costs will be significant whether absorbed at the federal or the state level.

Ultimately, however, Americans and the Congress will not countenance children being raised is abusive, drug-infested households or going hungry in the streets. We must begin a serious debate -- not a unproductive "war of words!!"

Denial of Higher AFDC Benefits for Additional Children

One aspect of our current welfare system that has attracted a lot of controversy is the fact that welfare recipients can automatically receive additional, higher benefits when they have more children. In some cases, this amounts to a perverse incentive for beneficiaries to remain on welfare and have more children, instead of taking responsibility for themselves and their families and getting off welfare.

A few years ago, the New Jersey State Legislature and then Governor Florio concluded that the welfare program back then was simply subsidizing unwed mothers and out-of-wedlock births, and that strong, corrective action was necessary. The State began denying AFDC recipients higher benefits for new children in August of 1993, and the preliminary results for this new initiative during its first twelve months indicate that births to AFDC recipients have been reduced by a little more than 10 percent. It is too early to precisely determine what caused this reduction, but the fact remains that this is an encouraging signal nonetheless.

On the federal level, we must follow this example and prohibit any automatic increase in AFDC benefits to mothers, already in the program, who have additional children. At the same time, the Committee should ensure that women on AFDC, who have additional children, can earn a higher amount of AFDC benefits by working without jeopardizing their current benefits. This second provision balances the desire to encourage AFDC recipients to earn their way off of welfare with the intent of not simply rewarding beneficiaries when they have more children by giving them more money.

Preventive Health Care and Immunization Requirements

For decades, States have required that children entering the school system be properly immunized and vaccinated. The record is clear: when we require immunization and vaccination as a condition of attending school, and tell parents that their children can't start classes without them, they do the right thing: they children make sure that kids get their shots!

Regrettably, either through ignorance or apathy, many parents in the welfare program today are failing to get their children immunized and vaccinated, making these children the real victims.

We must require parents to have their children properly immunized and up-to-date on their vaccinations in order to qualify for AFDC, WIC or Food Stamp benefits. State compliance with this requirement should be mandatory, not optional. Also, any day care and child care center that receives federal monies must be required to certify that these same immunization and vaccination standards have been met before enrolling any given child.

In 1992, six children died in New Jersey from an outbreak of the measles. It's a national disgrace that today -- just five years from the 21st century -- the United States (the world's most advanced country with the best medical care available) ranks down there with many Third World bloc countries when it comes to immunization and vaccination standards.

Immunizations and vaccinations are preventive medicine. Extensive medical and scientific evidence demonstrates that every dollar invested in childhood immunization saves ten dollars in future health care costs. There is no reason why AFDC, WIC or Food Stamp recipients should not have their children properly immunized, particularly when free -- or discounted -- immunizations and vaccinations are widely available in many communities.

Expand the JOBS workfare Program

There is widespread agreement amongst those who have studied the welfare system that we must significantly improve our efforts to assist and encourage AFDC recipients earning their way off of welfare and becoming productive, self-sufficient members of society.

We could establish mandatory, enhanced levels of participation in the JOBS workfare program for the States. For example, States could be required to have at least 25-30 percent of their AFDC recipients participating in the JOBS workfare program in the short-term, with these requirements gradually increasing up to 90-100 percent participation in the long-term.

In order to encourage States to meet these requirements, the federal government could reduce the amount of its contribution to a State's AFDC program by a certain amount, say 5 or 10% initially, with higher penalties being levied against States that repeatedly fail to meet these new federal requirements.

Block Granting Welfare Can Give States More Flexibility:

In recent days, there has been considerable speculation in the news media about ongoing negotiations between Republican Governors and Members of Congress about making welfare a block grant program. Essentially, these discussions revolve around the idea of taking many different federal programs, with their myriad of conflicting rules and regulations, and instead simply giving States a block grant of funds with some basic federal guidelines, and allowing States the flexibility to implement the welfare program they think suits their needs.

While I believe that this idea has considerable merit, I want to be clear about my thoughts on a related topic. Some have suggested that welfare programs should be changed from the entitlement segment of the federal budget to the discretionary portion.

I have very strong reservations about proposals of this nature. I state categorically: Children must not go hungry! If ensuring that children do not go hungry means welfare remains an entitlement program, so be it.

Strong Child Support Enforcement Reform is Welfare Prevention:

The second topic I would like to testify about is one which many members of this Committee have heard me talk about repeatedly in recent years: <u>Effective reform of our Child Support Enforcement laws must be an integral component of any welfare reform proposal that the 104th Congress sends to President Clinton.</u>

Both Republicans and Democrats may have vastly different ideas as to how we should be reforming welfare system, but most readily agree that Child Support Enforcement reform must be a critical component of any successful welfare reform proposal.

Make no mistake about it: effective Child Support Enforcement is welfare prevention. And a tough, comprehensive Child Support Enforcement title is a central and critical element to any effective welfare reform proposal. Non-support of children by their parents is one of the primary reasons that so many families end up on the welfare rolls in the first place.

Children who are deprived of the support to which they are entitled face a lifetime of economic, social and emotional deprivation. It's a national disgrace that our child support enforcement system continues to allow so many parents who can afford to pay for their children's support to shirk these obligations.

Finally, we must be clear. Failure to pay court-ordered child support is not a "victimless crime". The children going without these payments are the first victims. But American taxpayers are the ultimate victim, when they have to pick up the welfare tab for the deadbeat parents who evade their financial obligations.

As many members of the Committee recall, in 1994 I worked with a bi-partisan coalition of House members who tried to decouple Child Support Enforcement reform legislation from the Clinton Welfare Reform plan. Last summer, the Caucus on Women's Issues developed an omnibus package of Child Support Enforcement reforms (H.R. 4570), which we asked the bi-partisan leadership of the House to move separately from more controversial welfare reform legislation. Regrettably, the majority leadership of the 103rd Congress was unable to uphold their end of the agreement, and the Congress adjourned without acting on this serious problem. Child Support Enforcement reform legislation died without ever having even been brought to the floor of the House for a vote.

I am very, very pleased to see that new House leadership, both Speaker Gingrich and Majority Leader Armey, have made both welfare reform and Child Support Enforcement reform legislation items that **will receive action in the U.S. House of Representatives within our first 100 Days of session.** While there are a few modest Child Support Enforcement provisions in the Contract's Family Reinforcement Act, I support a much more comprehensive legislative solution to this serious problem. I look forward to being a part of the coalition that fulfills this solemn promise to the American people as this legislation moves through the 104th Congress.

The Caucus's legislation, (H.R. 4570, the Child Support Responsibility Act of 1994) represented a comprehensive reform of our child support enforcement system based largely on legislation I previously introduced, H.R. 1600, which in turn was drawn from the recommendations of the U.S. Commission on Interstate Child Support Enforcement.

U.S. Commission on Interstate Child Support:

As the Ways and Means Committee examines these recommendations, it may be useful to provide some background as to the nature, membership and report of the Commission.

I have long been a leading voice in this debate, on both the Child Support Enforcement Amendments of 1984, and the Family Support Act of 1988. Along with my colleague Mrs. Kennelly, and Senator Bill Bradley, I served as a member of the U.S. Commission on Interstate Child Support Enforcement.

The Commission was composed of experts in all areas of child support enforcement: family law judges and attorneys, state and local officials, caseworkers, and of course, parents and child support advocates. Our Commission was charged with a comprehensive review and report of recommendations for reform of our interstate child support system, which was completed in August of 1992.

Perhaps the most important fact revealed in the Commission's report was that our interstate child support system is only as good as its weakest link. States that have made child support a priority, and adopted aggressive reforms, are penalized by those states which have failed to reciprocate.

Or, as one of my county sheriffs told me, we will never be able to get parents to meet their child support obligations when they can "skip across" the Delaware or Hudson river into a neighboring state (PA or NY) to avoid payment.

That is precisely why we need comprehensive federal reform of our child support system -- to ensure that all states come up to the HIGHEST common denominator, not sink to the LOWEST common denominator as has happened all to frequently in the past.

Among the most important and effective "get tough" reforms that I have endorsed, and which must be included in either the Personal Responsibility Act, or the Family Reinforcement Act include:

Enhanced Hospital-based Paternity Establishment Programs:

Although the Clinton tax package of 1993 contained some provisions mandating comprehensive hospital-based paternity establishment programs, we may need to take further action. The alarming rise in single-parent families should give every one of us reason to act now. The most recent studies demonstrate the shocking rise in out-of-wedlock births, most prevalent in low-income populations, and across all ethnic groups. Without fail, every report we have seen on this subject documents the social and economic consequences to children raised without the support of both parents. It is well-documented and well-known.

This fact alone makes clear that the most crucial element for the establishment and collection of court-ordered child support must be paternity establishment.

The U.S. Commission in its report indicated that the one time when we are most able to obtain fathers' acknowledgment of paternity is at birth, in the hospital. The Commission estimated that more than **80%** of non-married parents are in contact with one another at the time of the child's birth. States that have emphasized outreach at hospitals and birthing centers have been particularly successful in increasing parentage determinations.

Comprehensive, hospital-based paternity establishment programs should build on that premise, and require all hospitals to have clear, simple and uniform procedures for parents to acknowledge paternity at birth. Moreover, we need to shift the burden of proof so that parents who have acknowledged paternity at birth cannot turn around when a support order comes and say "prove it".

Require States to Criminalize Failure to Pay Child Support

We must require all States to make it a crime to willfully fail to pay child support, and provide criminal penalties for 'deadbeat parents'. The federal government has wisely adopted federal criminal penalties for those who cross interstate lines to avoid child support. States should be held to the same standard, and use criminal penalties for those who choose not to pay.

Withhold Drivers' & Occupational Licenses for Deadbeat Parents

In our efforts to address some of the important gaps in our present system: require States to withhold drivers' and occupational licenses from "deadbeat parents". This has already shown very promising results in those states which have adopted it. For example, the State of Maine reports that in the first year of its program, more than $11 million in back child support were collected under these sanctions. By applying such proven methods on a federal level, we ensure that all States rise to the level of the best, rather than sink to the worst.

Increase Credit Reporting Efforts and Wage Garnishment

Increases the use of credit reporting and garnishment; and require uniform, national subpoenas to simplify burdensome paperwork requirements. We must improve and expand the national reporting of all support orders, and the computer data base of outstanding child support obligations.

The importance of this federal locator network cannot be understated. In fact, my own State of New Jersey, is using its computerized database of automobile registration to take aggressive action against auto scofflaws, intercepting tax refunds and garnishing paychecks.

Frankly, if we can find the resources and find a way to crack down on automobile fines, I would hope we would find the same resources to help parents get their court-ordered child support! In the past we have been told that problems in child support collection are a function of overwhelming caseloads and limited resources. Well, if we can find a way to put a lien on someone's house for a parking ticket, we ought to be able to use the same sanctions when they fail to pay child support.

Improving the federal data network on child support arrearage gives us the tool to put these tax intercepts, rebate refunds, and property liens to their fullest use!

Allow States to Serve Child Support Orders on Out-of-State Employers

We must change the law to definitively allow States to serve child support orders on out-of-state employers. This was clearly the intent of Congress when we adopted mandatory wage withholding for new child support orders. Unfortunately, the various levels of state bureacracy still make wage withholding unnecessarily complex and cumbersome. We must streamlines this process, and removes levels of bureaucracy from the child support collection process in order to allow wage withholding to work simply and effectively.

As the U.S. Commission noted, this "direct service" is one of the most successful methods of child support enforcement available, with success rates of 80% and more when used.

Prohibit the Federal Government from Aiding & Abetting Deadbeat Parents

Finally, we must adopt a pioneering reform that addresses the role of the federal government as an employer. We should prohibit the federal government from employing, paying benefits, or making loans to "deadbeat" parents!

We need to prohibit the federal government from "aiding and abetting" deadbeat parents who have failed to make court-ordered payments. The federal government should refrain from providing assistance to a "deadbeat parent" who owes more than $1,000 in back child support, and is making no court-arranged effort to repay the arrearage.

That we would refuse to subsidize the behavior of deadbeats would seem simple logic. Unfortunately, under current law, no such arrangement exists. Without such a safeguard, the government can and will continue to provide financial assistance and loans to a parent, without corresponding responsibility for court-ordered payment.

So "the left hand" of government can be paying taxpayer dollars in welfare to a single parent trying to raise children without court-ordered child support, while the "right hand" is providing deadbeats with a college loan or a government-backed mortgage! This may be the most classic example of "waste, fraud, and abuse" we find in the welfare debate, and we must end it here and now.

Establish a National Child Support Withholding Form for New Employees

One final point: as of January 1, 1994, all new child support orders are being delivered through employer-based wage withholding. We should create a national child support "withholding form" for new hires, and improve the computerized federal database for tracking child support orders. In short, our system makes employers a pivotal part of the child support collection process -- it is only right that the federal government, in its role as employer to millions, meet its responsibilities in this important area just as private employers must now do.

Again, I thank Chairman Archer and the Committee for providing me with this opportunity to share with you my thoughts about the need to reform our welfare system, as well as improve the nature of our Child Support Enforcement problem, and the solutions that I believe we must enact.

At this point in time, I'd be more than happy to answer any questions that the Committee's members might have.

Mr. CRANE. Thank you, Mrs. Roukema.
Now Mr. Smith.

STATEMENT OF HON. NICK SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. SMITH OF MICHIGAN. Mr. Chairman, thank you very much. Two years ago, during rescission, I was here suggesting that we need some way to stimulate business investment in this country, and I am here to encourage your consideration of what has been called neutral cost recovery that stimulates investment.

Business investment creates jobs and increases wages for American workers by raising our Nation's productivity. Simply put, it encourages businesses to put tools in the hands of our workers so that they can increase their efficiency.

It seems to me that the way we are going to put the tools in the hands of workers is not to penalize those businesses that decide to make investments in that machinery and equipment and have a tax policy that fairly taxes the real return on capital, in this case a return that neutralizes the loss from inflation and the time value of money.

In order to encourage businesses to invest in machinery and equipment, we need to stop penalizing businesses that make that investment. In other words, we should allow businesses to deduct the cost of equipment in the year of purchase or deduct an equivalent value in the outyears through depreciation.

It seems that we need to increase equipment purchases because by doing that, we will ultimately increase the productivity of labor, and raise wages. If we in this Congress can't figure out a way to leave a strong economy with good jobs to our kids and grandkids, then probably we should be going home and finding somebody who can.

Indexing depreciation, like capital gains indexing, makes sense and will increase the Nation's capital stock and add to the long-run growth of gross domestic product. While a capital gains tax cut will increase economic growth, it is not the only solution to encouraging business investment in new machinery and equipment that is going to increase our productivity and our competitiveness with a very strong world market.

Neutral cost recovery, which I introduced 2 years ago as H.R. 539 with 80 bipartisan cosponsors, was introduced on the first day of session this year as H.R. 199. This proposal has been endorsed by leading business organizations: The U.S. Chamber of Commerce, the NFIB, the National Federation of Independent Businesses, and the National Business Owners Association. These groups, I think, understand that we need to change our tax law to be fair and to have a tax law that is competitive with other countries of the world that now treat their businesses more favorably to encourage investment in machinery and equipment and facilities.

Mr. Chairman, members of the committee, we discourage capital investment in this country because we penalize those businesses that make that investment. We penalize them by not allowing them to consider that purchase of a machine or that equipment or facility as a business expense.

Under this bill, businesses would be allowed to expense or deduct the first $25,000 of capital investment. That is $17,500 now. This would raise it to $25,000. It would also index other depreciation to inflation and the time value of money. Neutral cost recovery would be an optional depreciation method. Existing forms of depreciation would remain available. By passing this legislation and reducing the cost of machinery and equipment, businesses would be encouraged to purchase more capital, and we would increase economic activity.

I just left a hearing in our Budget Committee with Alan Greenspan. We asked Mr. Greenspan, if you have a proposal like neutral cost recovery, that the Treasury later today is going to say costs tens of billions of dollars, and you have other estimators that say it is going to increase economic activity, how do you evaluate that proposal?

His reaction was, maybe it is not going to be that easy to change how we score these different tax proposals, but if it is fair and if it is going to increase economic growth and the potential for jobs, then we should pass it.

I would just like to say that, in contrast to what I expect Treasury to claim on the cost of this specific proposal, according to an independent study by Gary Robbins, who is a former Treasury estimator, neutral cost recovery would have several benefits.

It would reduce the cost of equipment by 16 percent. The guess is—and I have charts in my written testimony that show this—it is going to create an additional 2.7 million new jobs, and increase annual take-home pay by $3,300 over the next 5 years.

Robbins also estimated an additional $3.5 trillion in economic activity, bringing in billions of dollars to the U.S. Treasury. That is in contrast to static scoring which would suggest that it is actually going to cost the government less.

Mr. Chairman, I think it is important to note that over the last 20 years the United States has trailed most of our industrialized competitors in capital investment per worker, in part because they have more favorable tax policies. In our post cold war economy, other countries are doing everything they can to attract business investment. Obviously, the United States no longer has a monopoly attracting investment.

Countries with tax laws that encourage investment give themselves an advantage in attracting capital. For example, over the last 20 years U.S. investment growth in plants and equipment has been only half that of Japan and Canada.

We must recognize that we have to compete for capital investment. A study done by the American Council on Capital Formation found that U.S. corporate tax depreciation rules put us at a strong disadvantage because our competitors in other countries have much more favorable tax treatment.

In conclusion, I think it is important that we investigate this, not only because it is fair but because other countries are doing a better job of encouraging business investment. If we believe that investment in new machinery and equipment is going to increase our productivity and our competitiveness in the world market, then it seems important that we move ahead.

[The prepared statement and attachment follow:]

NICK SMITH, MEMBER OF CONGRESS
Testimony on Neutral Cost Recovery before the House Ways and Means Committee
January 10, 1995

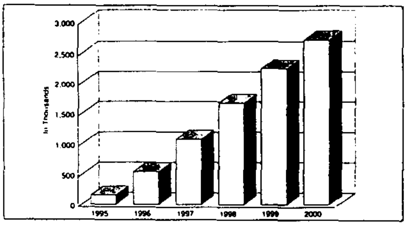
MR. CHAIRMAN...MEMBERS OF THE WAYS AND MEANS COMMITTEE, I AM HERE TODAY TO TESTIFY IN SUPPORT OF THE NEUTRAL COST RECOVERY ACT WHICH IS PART OF THE JOB CREATION AND WAGE ENHANCEMENT ACT IN THE CONTRACT WITH AMERICA.

INVESTMENT CREATES JOBS AND INCREASES WAGES FOR AMERICAN WORKERS BY RAISING OUR NATION'S PRODUCTIVITY GROWTH. WE CAN ACCOMPLISH THIS BY ENCOURAGING SAVINGS AND INVESTMENT THROUGH A TAX POLICY THAT TAXES THE <u>REAL</u> RETURN TO CAPITAL, THAT IS THE RETURN IN EXCESS OF INFLATION. IN ORDER TO ENCOURAGE BUSINESSES TO INVEST IN MACHINERY AND EQUIPMENT, WE NEED TO ALLOW BUSINESSES TO TREAT THEIR CAPITAL ACQUISITIONS AS BUSINESS EXPENSES. IN OTHER WORDS, WE SHOULD ALLOW BUSINESSES TO DEDUCT THE COST OF EQUIPMENT AS AN EXPENSE WHEN DETERMINING TAXABLE INCOME. THIS WILL INCREASE THE PRODUCTIVITY OF LABOR AND RAISE WAGES, AS WELL AS INCREASE OUR INTERNATIONAL COMPETITIVENESS. INDEXING DEPRECIATION, LIKE CAPITAL GAINS INDEXATION, MAKES SENSE AND WILL INCREASE THE NATION'S CAPITAL STOCK AND ADD TO THE LONG RUN GROWTH OF GROSS DOMESTIC PRODUCT.

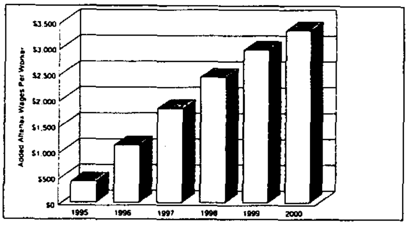
NEUTRAL COST RECOVERY, WHICH I INTRODUCED IN THE LAST CONGRESS AS H.R. 539, AND IN THE 104TH CONGRESS, AS H.R. 199, HAS BEEN ENDORSED BY LEADING BUSINESS ORGANIZATIONS: THE U.S. CHAMBER OF COMMERCE, THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS, AND BY THE NATIONAL BUSINESS OWNERS' ASSOCIATION. THESE GROUPS UNDERSTAND THAT OUR CURRENT TAX TREATMENT FOR EQUIPMENT, MACHINERY, AND FACILITIES IS NOT FAIR AND PUTS OUR BUSINESSES AT A COMPETITIVE DISADVANTAGE WITH OTHER COUNTRIES. MOST ECONOMISTS AGREE THAT ENCOURAGING CAPITAL INVESTMENT IS KEY TO ECONOMIC AND JOB EXPANSION. MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, WE DISCOURAGE BUSINESS CAPITAL INVESTMENT BECAUSE WE DON'T ALLOW THOSE PURCHASES TO BE CONSIDERED A BUSINESS EXPENSE. IN OTHER WORDS, BY REQUIRING BUSINESSES TO WAIT 5, 10, 15, OR 20 YEARS BEFORE DEDUCTING THE PURCHASE PRICE, INFLATION ERODES THE VALUE OF THE DEDUCTION.

UNDER NEUTRAL COST RECOVERY, BUSINESSES WOULD BE ALLOWED TO INDEX DEPRECIATION FOR INFLATION. THE DECISION TO USE NEUTRAL COST RECOVERY WOULD BE OPTIONAL FOR ANY BUSINESS. WHILE NOT EQUIVALENT TO EXPENSING, THIS PROPOSAL WOULD REDUCE THE COST OF EQUIPMENT AND ENCOURAGE BUSINESSES TO PURCHASE MORE OF IT.

ACCORDING TO AN INDEPENDENT STUDY BY GARY ROBBINS, A FORMER REVENUE ESTIMATOR FOR THE DEPARTMENT OF TREASURY, NEUTRAL COST RECOVERY WOULD HAVE SEVERAL BENEFITS. FIRST, IT WOULD REDUCE THE ECONOMY-WIDE MARGINAL TAX RATE ON CAPITAL BY 24%, RESULTING IN A 16% LOWER COST OF CAPITAL. SECOND, IT WOULD CREATE 2.7 MILLION NEW JOBS. THIRD, IT WOULD INCREASE WAGES BY $4,826 PER WORKER OVER THE NEXT FIVE YEARS. FOURTH, IT WOULD PRODUCE AN ADDITIONAL $3:5 TRILLION IN ECONOMIC ACTIVITY BY THE YEAR 2000, INCREASING GDP BY ONE TRILLION DOLLARS PER YEAR, A 1.8 PERCENT INCREASE ANNUALLY.



New Jobs From H.R. 539



Increase in Take Home Pay From HR 539

Neutral Cost Recovery: Investing for Growth, Not Planning for Taxes

By:

Gary Robbins
Aldona Robbins

Taxation TaxAction Analysis™
The Tax Policy Arm of the Institute for Policy Innovation
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MR. CHAIRMAN, IT IS IMPORTANT TO NOTE THAT OVER THE LAST 20 YEARS, THE UNITED STATES HAS TRAILED MOST OF OUR INDUSTRIALIZED COMPETITORS IN CAPITAL INVESTMENT PER WORKER, IN PART BECAUSE THEY HAVE MORE FAVORABLE TAX POLICIES. IN OUR POST COLD WAR ECONOMY, OTHER COUNTRIES ARE DOING EVERYTHING THEY CAN TO ATTRACT INVESTMENT. THE U.S. NO LONGER HAS A MONOPOLY ATTRACTING INVESTMENT. THE COUNTRIES THAT HAVE TAX LAWS THAT ENCOURAGE INVESTMENT WILL HAVE AN ADVANTAGE IN ATTRACTING CAPITAL. OVER THE LAST 20 YEARS, U.S. INVESTMENT GROWTH IN PLANTS AND EQUIPMENT HAS BEEN ONLY HALF THAT OF JAPAN AND CANADA. WE MUST RECOGNIZE THAT WE HAVE TO COMPETE FOR CAPITAL INVESTMENT.

A STUDY BY THE AMERICAN COUNCIL ON CAPITAL FORMATION FOUND THAT U.S. CORPORATE TAX DEPRECIATION RULES PUT US AT A STRONG DISADVANTAGE WITH OUR COMPETITORS. MR. CHAIRMAN, AND MEMBERS OF THE COMMITTEE, WE HAVE A CHANCE TO ATTRACT MORE CAPITAL INVESTMENT, INCREASE PRODUCTIVITY, AND EXPAND JOB OPPORTUNITIES BY ADJUSTING DEPRECIATION FOR INFLATION AND THE TIME VALUE OF MONEY. MR. CHAIRMAN, I WOULD LIKE TO THANK YOU AND THE COMMITTEE FOR YOUR EFFORTS. THROUGH THE CONTRACT WITH AMERICA, WE HAVE THE OPPORTUNITY TO STRENGTHEN THIS NATION'S ECONOMY. LET'S IMPLEMENT NEUTRAL COST RECOVERY, INDEX CAPITAL GAINS FOR INFLATION, SUPPORT SMALL BUSINESS GROWTH BY INCREASING THE EXPENSING LIMIT TO $25,000, AND ENCOURAGE SAVINGS THROUGH INCREASED IRA'S. THE NET EFFECT WILL BE A NATION WITH MORE AND BETTER JOBS.

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PAGE A20 / FRIDAY, JANUARY 6, 1995 ★ The Washington Times EDITORIALS

If we want to be competitive, we must stop penalizing investment

As the sponsor of the neutral cost recovery legislation in the "Contract with America," I commend John Goodman's Dec. 22 Op-Ed article, "Want to 'grow' the economy? Here's how to do it."

Mr. Goodman's analysis demonstrates that there is a relationship between corporate taxes and economic growth. The current tax treatment of corporations in this country places many of our companies at a competitive disadvantage to businesses in other countries. This disadvantage ultimately results in fewer jobs and a lower standard of living for American workers.

The primary way a society raises the standard of living is by increasing its stock of physical capital. This is evident to anyone who has used a new machine at work to increase productivity. Neutral cost recovery, by offsetting some of the bias against capital in the tax code, will increase the capital stock and lead to higher incomes for American workers. A recent study by TaxAction (the tax policy division of the Institute for Policy Innovation) estimates that the average worker will receive in excess of $3,300 in additional take-home pay within five years of the implementation of the legislation.

Neutral cost recovery would be available to all firms that pay tax on their income, from the Fortune 500 down to the one-person barber shop on the corner. Depreciation allows a business to account for the wearing-out of machinery or tools in the course of production, and subtract this cost of business from income. In order to measure depreciation properly, neutral cost recovery adjusts depreciation schedules in two ways. It takes inflation into account to reflect the falling value of the currency, and it makes an additional 3.5 percent adjustment corresponding to the time value of money.

Further, the deduction under neutral cost recovery remains the same, regardless of how machinery is financed. If a firm gets a deduction for interest paid on the loan under another section of the tax code, then the lender will pay taxes on the interest that was deducted by the firm. Thus, neutral cost recovery is not a debt-financed tax subsidy as some opponents have claimed.

The real issue with neutral cost recovery is how to create more and better jobs. Between 1972 and 1991, the United States ranked next to last among the G-7 industrialized countries in the growth of investment. Other industrialized countries such as Italy, Germany and Japan all have more favorable tax policies to encourage capital investment.

If we want to increase productivity and our competitive position in world markets, it is important to stop penalizing investment. Neutral cost recovery is simple and fair, makes the tax code more economically efficient and will result in higher wages and incomes for working Americans.

NICK SMITH
U.S. House of Representatives
Washington

Mr. CRANE. Thank you, Mr. Smith.
Next is Mr. Largent.

STATEMENT OF HON. STEVE LARGENT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA

Mr. LARGENT. Thank you, Mr. Chairman. I would like to thank you and the remaining, persevering members of this distinguished panel for the opportunity to appear before this committee to discuss the Contract With America and its implications for the American family.

I appear here today not only as a Member of Congress but more importantly as a husband and a father of four young children. I know firsthand what it costs to raise a family in middle America. I am glad that the Republicans have promised tax relief for families and have embraced other policies in the Contract that advance and promote strong families. Remember, as families go, so goes the Nation.

The family is the cornerstone of society. It is the campaign that I led for the last 6 months for this seat. As we have watched the breakdown of the American family we have increasingly seen the degradation of our society.

The failure of the welfare state has proven that the rebuilding of our society cannot be done at the direction of Washington. It must come through the restoration of the institutions that are vital to our civilization, and at the most fundamental level that means the renewal of the family.

The family is the cornerstone of society. Washington cannot renew the family, but we, as policymakers, can remove some of the burdens that press down on the formation and the well-being of the family. That is why we need to enact policies like those embodied by the Contract With America and its implementing legislation.

For example, the Contract With America provides tax relief for parents raising children. Marriage is rewarded, not penalized, through the Tax Code. To stabilize lifetime income for families, IRAs are expanded and improved. The Contract also provides tax credits for families who care for an elderly parent or grandparent or who adopt children.

I believe Congress must act now to relieve the unfair tax burden on families with children. We should do everything in our power to make it easier to form families and to keep them strong.

Raising children requires resourcefulness and a serious commitment to their emotional, physical and financial well-being. Today, parents must be willing to dedicate as much of their time and resources as they can in order to ensure the well-being of their children.

One study shows that in 1960 the average parent spent 30 hours a week in close, intimate contact with their children, and yet by 1990 that number had declined to 17 hours per week that they spent with their children. Why? In great part to relieve the tax burden on their families.

For too long, families with children have been overtaxed. When Harry Truman was president in 1948, the average American family with children sent only 3 percent of its income to Uncle Sam. Today, that same family sends 24.5 percent to Washington.

I was surprised to learn that in Washington "budget speak," a $500 tax credit is considered a "cost to government" because it is a revenue loser. Tax relief for families should not be looked at as a "cost to government." Instead, we should consider it as a way to keep money in the hands of those to whom it belongs in the first place: America's working families.

According to the Heritage Foundation, the $500-per-child tax credit would allow $55 million to stay in the household budgets of families from the First District of Oklahoma. I am infinitely more confident that these hard-working families of my home State will use their own money much more wisely than the government ever could, no matter which party is controlling the Federal budget.

Not only should we enact the $500-per-child tax credit, but reform of the marriage penalty is long overdue. Formation of families ought to be promoted, not penalized. Marriage should be a commitment to love and to cherish, not to pay higher taxes.

The American dream savings accounts will help all Americans to save for retirement, encouraging families to be self-reliant and less dependent on the whims of government policies. These special IRAs promote long-term prosperity through the growth of capital to invest in America. Stay-at-home moms and dads can participate in this unique savings plan as well.

The savings in American dream accounts can be withdrawn for retirement income, a first-time home purchase, for postsecondary education expenses or toward medical expenses. This flexibility encourages even more savings than at the present time by allowing families to make decisions that are best for them and their changing circumstances without the danger of locking away too much money in an account they can't get to without paying a substantial penalty.

Family tax relief is crucial. Nevertheless, we must simultaneously work toward another daunting task—a balanced Federal budget. I hear many of my colleagues in Washington, D.C., these days say that we are not going to pass the balanced budget amendment unless we first explain how we are going to do it.

I have to say that I disagree with that logic. I think we need to put those golden handcuffs on the hands that are writing the rubber checks here in Washington, D.C.

In conclusion, Mr. Chairman, I promise you and the members of this committee that I will work faithfully on the Budget Committee to ensure that we cut spending first in order to pass along the savings to American families and children.

Once again, thank you for this opportunity to testify.

[The prepared statement follows:]

Congress of the United States
House of Representatives
Washington, DC 20515–3601

Testimony of Rep. Steve Largent

Before the Committee on Ways and Means

Fairness for Families First

January 10, 1995

Thank you, Mr. Chairman and members of this distinguished panel, for the opportunity to appear before this Committee to discuss the Contract with America and its implications for the American family.

I appear here today as a Member of Congress, but more importantly, I speak as the father of four young children. I know first-hand what it costs to raise a family in middle America. I'm glad that Republicans have promised tax relief for families and have embraced other policies in the Contract that advance and promote strong families. Remember: as the family goes, so goes the nation

The family is the cornerstone of society. As we have watched the breakdown of the American family, we have increasingly seen the degradation of our society. The failure of the welfare state has proven that the rebuilding of our society cannot be done at the direction of Washington. It must come through the restoration of the institutions vital to our civilization -- at the most fundamental level, that means the renewal of the family. The family is the cornerstone of society. Washington cannot renew the family, but we, as policy makers, can remove some of the burdens that press down on the formation and well-being of the family. That is why we need to enact policies like those embodied by the Contract with America and its implementing legislation.

For example, the Contract with America provides tax relief for parents raising children. Marriage is rewarded -- not penalized through the tax code. To stabilize life-time income for families, IRAs are expanded and improved. The Contract also provides tax credits for families who care for an elderly parent or grandparent, or who adopt children.

Family Tax Relief

I believe Congress must act now to relieve the unfair tax burden on families with children. We should do everything in our power to make it easier to form families and keep them strong.

Raising children requires resourcefulness and a serious commitment to their emotional, physical and financial well-being. Today, parents must be willing to dedicate as much of their time and resources as they can in order to ensure the well-being of their children.

For too long, families with children have been overtaxed. When Harry Truman was President in 1948, the average American family with children sent only 3 percent of its income to Uncle Sam. Today, that same family sends 24.5 percent to Washington.

I was surprised to learn that in Washington "budget-speak," a $500 tax credit is considered a "cost to government" because it is a "revenue loser." Tax relief for families should not be looked at as a "cost to government." Instead, we should consider it as a way to keep money in the hands of those to whom it belongs in the first place: America's working families.

According to the Heritage Foundation, the $500 per-child tax credit would allow $55 million to stay in the household budgets of families from the First District of Oklahoma. I am infinitely more confident that these hard-working families of my home state will use their own money much more wisely than the government ever could -- no matter which party is controlling the federal budget.

Promoting Marriage and Family Savings

Not only should we enact a $500 child tax credit, but reform of the marriage penalty is long overdue. Formation of families ought to be promoted, not penalized. Marriage should be a commitment to love and to cherish, not to pay higher taxes.

American Dream Savings Accounts will help all Americans to save for retirement -- encouraging families to be self-reliant and less dependent on the whims of government policies. These special IRAs promote long-term prosperity through the growth of capital to invest in America. Stay-at-home moms and dads can participate in this unique savings plan as well.

The savings in American Dream Accounts can be withdrawn for retirement income, a first-time home purchase, for postsecondary education expenses, or towards medical expenses. This flexibility encourages even more savings than at present by allowing families to make decisions that are best for them and their changing circumstances, without the danger of locking away too much money in an account they can't get to without paying a substantial penalty.

Balanced Budget Amendment

Family tax relief is crucial; nevertheless, we must simultaneously work towards another daunting task -- a balanced federal budget.

Mr. Chairman, I want you to know that I plan to work diligently with this Committee and the Budget Committee on which I serve to cut spending, cut taxes for families and balance the budget. The task before us is not easy; however, I believe it can and must be done.

In President Reagan's first inaugural address, he stated,

> "We are a nation that has a government -- not the other way around. And this makes us special among the nations of the Earth. Our government has no power except that granted by the people. It is time to check and reverse the growth of government which shows signs of having grown beyond the consent of the governed. It is my intention to curb the size and influence of the Federal establishment and to demand recognition of the distinction between powers granted to the Federal Government and those reserved to the States or to the people. All of us need to be reminded that the Federal Government did not create the States; the States created the Federal Government... Now, so that there will be no misunderstanding, it is not my intention to do away with government. It is, rather, to make it work -- work with us, not over us; to stand by our side, not ride on our back."

It's time to look at every federal program, examine every appropriation, and take a microscope to each line-item in the budget and ask if the Framers of our Constitution would allow the federal government to spend money in this way. As each check goes out, drawing on the Federal Treasury, we must ask if the federal government should be spending hard-earned tax dollars on this item in the first place.

We cannot simply trim government spending -- the task is too large. We must go the core of every program and question its very existence. Yes, the task is enormous -- the Congressional Budget Office projects a deficit for 1995 at $176 billion and a national debt of $3.6 trillion. However, I believe it can and must be done.

This is where Congress can learn directly from families.

In my family, if we don't have the money, we cut back on our expenses. It's that simple. After looking over the books of the federal government and learning that 14 percent of the budget goes just to pay the interest on the national debt, I think my family's straightforward budgeting technique must be a strange and foreign concept here in Washington.

The Fiscal Responsibility Act embraces the Balanced Budget Amendment and the Line-Item Veto. A balanced federal budget will ensure that our children are not saddled with the ever-mounting debt Washington has accrued. The Balanced Budget Amendment takes away the threat that our children will pay enormous rates of taxation to pay for the spending incurred by today's special interests. The line-item veto is one additional tool to help trim shameless porkbarrel spending.

In closing, Mr. Chairman, I promise you and the members of this committee that I will work faithfully on the Budget Committee to ensure we cut spending first in order to pass along the savings to American families and children. Once again, thank you for this opportunity to testify.

Mr. CRANE. Thank you, Mr. Largent.

Next is Mr. Foley from Florida.

STATEMENT OF HON. MARK FOLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. FOLEY. Thank you, Mr. Chairman. I again would like to thank you for the opportunity as a freshman joining the 104th Congress to testify before this important committee.

We have signed a Contract, and it spells out a few things to me. One is accountability. On the first day, we dealt with accountability, and we will have a further opportunity to deal with the accountability of elected officials when we bring up term limits.

Personal responsibility is also a key provision in reforming welfare, in reforming the legal system, to restore greater personal responsibility of every individual of our society toward their country.

What I would like to focus on today, in testimony is on economic opportunity, specifically the capital gains tax cut and the debt buydown. Let me relate to you just simply as a small businessman from Lake Worth, Fla., how the capital gains tax affected myself and my family.

I had an opportunity to sell a piece of real estate that I had owned since 1975. After considering the purchase offer I had to look very closely at the tax implications on the sale. The tax liability that I would have incurred and my family would have incurred—being my parents and my sisters that own the property with me—would have been over $36,000 in cash.

I had to look at that very carefully because my net takeout after the Contract would have been significantly, significantly decreased because of that tax obligation. So I passed on that opportunity to sell the real estate. We are putting it back on the market for rent, fixing up the property slightly, but it will basically go back as a rental income property.

Who lost in that transaction? Well, certainly I did. I lost a little bit of an opportunity to get some cash in my pocket. Certainly the government lost because they don't get the $36,000 that I have chosen not to give them.

But let's look at the other beneficiaries of a capital gains tax cut. Let's look at local and State and county government that share in the rewards of a sale of that piece of real estate. The State of Florida alone on documentary stamp tax on the transfer of that deed would have had over $1,300 of tax income to the people of the State of Florida due to that sale.

But it is not just the beneficiaries of government. County tax collectors would have gotten their piece of the pie, recording officers of the clerk's office. The courts would have gotten recording fees.

But let's talk about the average American that is working in my community. The title insurance company that would have written the title policy lost over $1,200 to their company. And that didn't just include the executive. That included the title inspector. That included the secretaries within that office.

And let's talk about the pest control company that would have come out and done an inspection on that property. Small fee maybe of $50, but, again, their income has been depleted.

Let's talk about the roof and structural inspectors, the environmental auditors that we require in government to get on with radon testing and all the other things that government has mandated over the last several years. That income is gone, no longer in their pockets, no longer will show up in the Treasury as earned income for those individuals. So they in fact have lost due to my decision not to sell the property.

If we will reduce the capital gains tax cut, I think many middle-class people much like myself would benefit from it.

Now, it has been charged that a capital gains tax cut is merely for the rich. Well, I got here and certainly my net worth statement was published in many publications, particularly by my opponent, but it has gone down about $250,000 since I joined the ranks of elected officials back in 1990. I certainly am not rich. I am like every other American working for a living.

So I think it is incumbent upon this Congress to work seriously on a capital gains tax cut not only to spur the investment opportunities of every American but also to increase the opportunities of the working Floridians and Americans around this country who are looking for opportunities.

Let me spend a moment on the debt buydown because I think that is critically important if we are to get our fiscal house in order. Payment on interest alone this year will exceed 14 percent of our budget, and it will continue to grow. If we give our citizens the opportunity to check off a debt buydown provision that they would like 10 percent of their tax obligations to go toward reducing the Federal budget deficit, I think we will have restored a faith in this government and a faith in this Congress.

Why is the debt growing out of control of concern to myself? When we talk about every issue that faces us today—Social Security, crime, welfare, education—those dollars that could be going to vital programs within our communities' boundaries are now going to pay a debt, a debt of this government that has been increasing over the last several decades and that will continue to grow unless we affirmatively, as a Congress, urge our citizenry to participate in the debt buydown.

Just like a Christmas club account, just like a savings account for vacations, just like every American saves in an account for their future, just as every American saves for their children's education, the debt buydown gives the citizenry a chance to say, yes, I believe the Federal budget deficit is of serious concern to us, and we have to address that. I think it is an important step for this Congress.

I thank the Chairman and the members of the committee for their diligence, their pursuit of the goals of the Contract, and I urge them to work diligently on these reforms. I think it will make a tremendous difference, and I thank the Chairman for the time.

[The prepared statement follows:]

Testimony of the Honorable Mark Foley
of Florida
Before the House Committee on Ways and Means
January 11, 1995
The Contract With America

Mr. Chairman, I would like to thank you for allowing me the opportunity to testify before the Committee on aspects of the Contract With America. On behalf of myself and all of the members of this year's historic freshman class, I would also like to thank you for your leadership in holding these important hearings which will certainly lead to fundamental changes in the way government does business and enhance the economic opportunity of Americans for generations to come.

My testimony today will focus on two aspects of the Contract contained within the Job Creation and Wage Enhancement Act which I believe are of utmost importance for the economic viability of this country. First, I would like to discuss the proposed cut in the Capital Gains Tax rate contained within the bill, and secondly, I would like to discuss the taxpayer debt buydown provision. However, before I begin on these specific provisions, I would like to briefly discuss some of the core principles underlying the Contract with America from the perspective of a freshman Member of Congress.

As a signatory of the contact, I couldn't agree more with the three core principles of the Contract - accountability, responsibility, and opportunity. The historic opening day of the 104th Congress ushered in fundamental changes in the way Congress does business, making the people's House more accountable to the people who have sent us here. The fundamental changes in the way the House of Representatives does business, including the unanimous vote to apply laws to Congress were just the beginning of increased era of Congressional accountability. I believe that an upcoming vote on Congressional term limits will truly give this institution back to the people.

Personal responsibility is one of the foundations of American liberty; however, recent years have seen an erosion of personal responsibility and reliance on big government. This in turn has led to skyrocketing budget deficits, an astronomical public debt and a seemingly unbreakable cycle of poverty due to an over reliance on the welfare state. It is my hope that the provision contained within the Contract to reform the welfare as well as the legal system will promote greater personal responsibility and end the dependence on big government which has emerged in recent years.

But the core principle I want to focus on today is increasing opportunity, especially future economic opportunity in this country. The United States has always been considered the land of opportunity, yet burdensome federal regulations, enormous tax burdens on individuals and small businesses have resulted in a loss of vision, of hope, and of opportunity around this nation. I believe that one of the first steps to increasing economic opportunity in this country would be a cut in the capital gains tax rate.

Capital Gains Tax Cut

As a small businessman, I applaud the provisions of the Job Creation and Wage Enhancement Act which effectively halves the capital gain tax rate, as I believe this provision will spur economic growth and opportunity around the country, not just to investors but to wage earners alike.

Let me relate a personal experience to the Committee, as the owner of a piece of real estate in Palm Beach County, I was recently precluded from selling this piece of land due to an enormous capital gains tax obligation of approximately $36,000 I would have incurred had I sold the property. Had the rate been halved, I would have been much more likely to sell the property, which in turn would have expanded economic opportunity for the various people who would have been involved in the transaction, including the title insurance company, the surveyors, the environmental auditors, and various building inspectors. As you can clearly see, the net effect of a cut in the capital gains tax rate would have been expanded economic opportunity to many involved in the process of selling the property, and not just the investor. In response to those who claim this tax cut will inflate the budget deficit, it is my belief expanded economic activity due to decrease in the capital gains tax rate will in turn lead to greater income throughout the American economy, more than making up for the direct loss to the Treasury from a decrease in the tax rate.

Opponents to the cut in the capital gains tax rate view it as a tax cut for the rich; yet, in the instance I just described to the Committee, it is clear that those who would benefit the most from this tax cut would be those on the periphery involved in the sale. Furthermore, I don't believe that you can look at this aspect of the Contract alone, it must be taken it context of the overall picture of what is being done in the Contract to bring tax relief to the already overburdened small businesses and individuals in this country.

Debt Buydown

Without a doubt, this country has entered a fiscal crisis of an stifling national debt. Payment on interest alone takes up a disproportionate share of the federal budget each year resulting in lost opportunities for potential uses of taxpayer money and increasing the burden on future generations. I have seen that in the past, each time the federal budget is announced, interest on the debt is taking up a larger and larger portion of the pie chart accompanying the budget.

The time has come to end the cycle of huge budget deficits and exponentially expanding the public debt - the time has come to reduce the principle on the money owed by the federal government. One tool that should be considered is the debt buydown provision contained within this bill. By empowering taxpayers to designate up to 10% of their tax liability to a public debt reduction fund we will be giving the power back to the people who are fed up with Congress and the Executive Branch continually bickering on who is responsible for the four trillion dollar debt. The time has come to act and give the taxpayers a say in reducing the public debt.

While detractors from this idea may say that giving taxpayers the power to designate what use their tax dollars should go for is not a good idea because it detracts from the power of the government to fulfill necessary obligations. I would say that the future of this county is by far the most important issue facing this country, and right now the future is in serious jeopardy because of the present debt crisis. It has become clear that the government is not taking advantage of the best uses of the American taxpayers money, as our debt obligations grow. Instead of money being sent to the states to help reduce crime by hiring more police officers or building new prisons, more money is being spent to pay for the interest alone on the debt. Instead of money being allocated to enhancing border patrols, these type of assets are being cut back in order for more money to go to pay the interest on the debt. Instead of money going to programs that work and make a difference in a child's life like Head Start, a bigger slice of the pie is going to interest payments. The increasing costs of paying the interest alone on our debt is clearly being felt in the lost opportunities, and the American taxpayer getting less and less out of their hard earned tax dollars. The debt reduction buydown is an experiment which we must try, our future is far too important.

Thank you, Mr. Chairman, for this opportunity to testify before your distinguished Committee, and I would be happy to answer any question you or members of the Committee may have.

Mr. CRANE. Thank you for your testimony.
Now Mr. Souder.

STATEMENT OF HON. MARK E. SOUDER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. SOUDER. Thank you, Mr. Chairman and members of the committee. I appreciate the opportunity to be here today.

You have my statement, so if I could just make a few summary comments and add an additional few comments.

I had the privilege of being the Republican Staff Director for 4 years at the House Select Committee on Children, Youth, and Families, and have worked over in the Senate on social issues.

Bob Woodson challenged me early on and said: "Do not be a typical guy who just pronounces what is wrong, but go out and meet people at the grassroots level. See what is working. Because all across America, in the middle of the worst places, there are programs and individuals who are making an impact."

And I did that. I blew two engines on my car. I was in Philadelphia, South Bronx, Brooklyn, Harlem, Chicago, into Watts multiple times, Miami, Fla., and met people in the middle of the most desperate places in America who are making a difference. And I can guarantee you it was predominantly not the welfare system.

I am proud of what we are attempting to do in a number of the reforms before Congress. I think it is important that in Congress we look at these problems in a holistic way and not individualized in the sense of capital gains. Tax reform is needed. You cannot do it without child support reform.

But one of the things I just wanted to raise today—it may not be in the first part of the Contract, but I hope that we will look at it soon—is a supplemental way to look at the welfare question. In every State in the country, regardless of whether it is a Republican or a Democratic Governor, social welfare spending is frozen or declining in real terms, yet the problems are increasing. And we have to figure out how to make it work and how we are going to deal with this burgeoning problem in America.

I have a three-part proposal to do what Peter Drucker calls the nonprofitization of the social service sector, and that is, first off, to increase the charitable deduction to $1.10 on the dollar; second, to allow nonitemizers to take a charitable deduction; and third, to let corporations take a charitable deduction of up to 15 percent. Quite frankly, the major urban areas will be where big dollars come in for the major projects, because they are in a higher tax bracket. I believe that's the type of movement of dollars that Marvin Olasky, who has an excellent book that has been quoted a number of times in the last week, talks about. Olasky maintains that government programs cannot produce the faith, the hope, the love, the personal care that the private sector does, nor can it foster the accountability that the private sector does.

Woodson and William Raspberry and others have also pointed out that 85 percent of the social programs in the African-American and the Hispanic communities that are effective are religion-based. I don't want the government telling me what to do with my money. I don't desire to fund religious groups that disagree with me. Nor do I want the government telling my church what to do. The charitable deduction is a way for individuals to choose where to put their money without the regulation that would result from the separation of church and State questions. I believe that we need to look at this very carefully.

I personally oppose wiping out all welfare expenditures and transferring the charitable programs totally to the private sector because I don't think it will work in the major urban areas, but I think it is a process that we need to begin, just like privatization.

I appreciate the opportunity to raise that today. I don't know whether it can be in this first round, but I hope that we will look at that in the long term.

[The prepared statement follows:]

STATEMENT OF THE HONORABLE MARK E. SOUDER
BEFORE THE COMMITTEE ON WAYS AND MEANS

TUESDAY, JANUARY 10, 1995

Mr. Chairman, I want to thank you and the members of the Committee for allowing me to testify before you today. This session of Congress promises to be a historic one, and this committee will take up a large portion of this year's landmark legislation. I appreciate the opportunity to present my views to you this afternoon.

The guiding principles behind the Republican "Contract with America" can be summed up in three statements: One, many government programs are too big, too expensive, and too intrusive; two, not only do these programs waste taxpayers' money, but they often hurt the very people they are intended to help; and, three, private organizations and individuals can do a better job than federal bureaucracies if the government will just get out of their way.

The present welfare system is a case in point. Since 1965, the federal government has spent $5 trillion on means-tested welfare. In doing so, we have elbowed out of the way numerous private groups that had been addressing America's social ills for generations, and replaced them with Washington bureaucracies. America's poor lost out in the bargain: today's statistics point to worsening conditions for the underprivileged, at skyrocketing costs for taxpayers.

Getting back to a rational and workable social welfare policy will not merely be a matter of cutting programmatic costs and establishing tougher eligibility requirements for Washington's largesse. Righting the policy wrongs of the last few decades must entail a significant devolution to the private sector of both the responsibility and the means to care for our society's less fortunate.

For these reasons, I want to urge the Committee to carefully consider -- either as part of the "Contract" legislation on welfare reform or in a subsequent tax bill -- my proposal to expand the tax deduction for charitable donations for both individuals and corporations.

I will soon be introducing legislation to effect the following changes in tax policy:

1) Allow individuals to deduct 110% of the value of their charitable donations

2) Allow non-itemizers to deduct the value of their charitable donations

3) Raise to 15% the current 10% charitable donation limitation on corporations.

These changes will begin to shift the burden of caring for those in need from government programs that have succeeded chiefly in wasting taxpayers' money, to philanthropic organizations, charities, and other private groups that over the years have compiled much better track records at a fraction of the cost.

Certainly many other reforms are needed, but they are unlikely to take root if we are not successful in revitalizing America's proud tradition of volunteerism. This tradition has been increasingly crowded out by an ever-expanding government. By encouraging Americans to give generously of their time, talent and treasure, we will allow the existing voluntary sector to stretch dollars farther and more effectively than Washington, D.C., ever could.

Author and scholar Marvin Olasky has observed: "The major flaw of the modern welfare state is not that it's extravagant with money, but that it's stingy with the help that only a person can give: love, time, care, and hope." Raising the charitable deduction is a good start in re-creating the societal bonds and affiliations that have been so drastically weakened by years of well-intentioned but wrong-headed government policies.

Thank you very much for your time this afternoon.

Mr. CRANE. I thank you for your testimony.

At this point I know Mr. Camp has questions. Are there any others that want to be recognized?

All right, Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman. I will just be brief.

I want to thank all the Members for their excellent testimony but particularly my colleague from Michigan for the Neutral Cost Recovery Act. That is the first step in recognizing that we are not as competitive as our neighboring countries are when it comes to capital, and I want to compliment you in taking the lead in trying to increase our efficiency, our productivity and our competitiveness. Thank you for your testimony.

Mr. CRANE. Thank you.

Mr. Jacobs.

Mr. JACOBS. Mr. Chairman, I don't have a question, but I did want to say for the record that I particularly appreciated Mr. Smith's testimony. I believe he is one of the most thoughtful Members of the Congress. I guess we are all sincere, but he is very sincere in his proposals.

Mr. SMITH OF MICHIGAN. Thank you.

Mr. CRANE. Thank you.

And Mr. Houghton.

Mr. HOUGHTON. I would like to follow up with what Mr. Jacobs said because I think it is a good issue that you are talking about here in terms of neutral cost recovery.

I always remember the story of Russell Long saying that I voted for investment tax credits to come in four times and I voted for them to go out four times and I am sure they will come back in again.

What have you got to suggest in addition to the excellent idea for us to glue on to this thing for awhile? Because it comes in and it goes out, and we are uncompetitive and we are competitive. And it never seems to hold, and that is our problem. So if it comes in again there is going to be an attraction to cut this thing off at a later time unless somehow we find a way to make it more meaningful to the Members of Congress.

Mr. SMITH OF MICHIGAN. My brief reaction would be that the investment tax credit was an arbitrary proposal that led to some firms being able to actually make a profit and depreciate more than they would otherwise be allowed to depreciate so taxpayers financed increased income.

This proposal is not arbitrary but absolute. It simply says to a business, if you purchase this equipment we are going to either allow you to expense or deduct the full cost in the year of purchase or we are going to allow you to depreciate in future an equivalent value.

Number one, it seems fair. Number two, what we really need to look at is what the rest of the world is doing. I see in the Wall Street Journal yesterday that Japan is increasing its productivity, so it seems to me that if it is fair, we should do it in such a way that nobody has excessive benefits. We should rule out the possibility of excessive leasing benefits, which this does, then we will be on the track to a solid, stable, fair treatment of that for that investment.

Mr. HOUGHTON. OK. Well, I have got another question for Mr. Largent.

Mr. Largent, your testimony is impressive, and I relate to it very much because I come from a rural area, and family values are very, very important there. Not that they aren't in the metropolitan areas, but I particularly identify with them up there.

But, you know, we are not talking about, I don't think, the types of families that you are talking about. We are talking about dysfunctional families. We are talking about families who really are in need, can't get together, dependent upon a variety of different things that the normal sort of classic family isn't. What do you do about these people? How do we handle them? This is the issue.

Mr. LARGENT. I think I can speak to that because I come from a dysfunctional family. I was raised in a single parent family, and I can tell you that I can fully appreciate the struggles that many families like that in our country and in my district are faced with, and it is a challenge.

I would just say that having four children myself—and I don't mean this to sound cold or callous—children are expensive, no matter where they are. It is one of the situations you can't live with them and you can't live without them.

But I would just say that the $500 tax credit, which is what I came to speak to in particular, addresses all these children. We don't discriminate against children on a $500 tax credit. So, you know, I can appreciate the problem, having, as I said, been a product of a single parent family myself.

Mr. HOUGHTON. OK. One other question. Mr. Foley, you know you talk about a couple of areas. One was the debt buydown. And I mean, I can understand how it is an attractive thought to have 10 percent of your taxable income designated as a debt buydown, but the problem is not with the citizens. The problem is with Congress. So where I pay a tax of $100 and 10 percent of that is dedicated to a debt buydown, at the same time I am borrowing as a Member of Congress $5 or $6. There is something missing there. I don't quite understand what the thrust is.

Mr. FOLEY. Well, obviously, that is the problem in Congress. We are spending more than we take in. We believe we have an unlimited gold Visa card, and we continue to charge on behalf of the American taxpayer. They are no longer willing to sign the voucher. I think they want to participate in the debt reduction. And we are going to have to constrain ourselves on spending. We are going to have to get serious about downsizing agencies.

We have gone through this exercise in the State of Florida when we had a tremendous budget crisis. We discharged a lot of people from the Department of Education, from HRS. We had to show fiscal restraint because we had to have a balanced budget.

We couldn't go past the margins and say, well, we will keep everybody in place and hope the economy gets better, borrow until it does, then pay it back. That is not the way the State was allowed to operate.

And I think by having the debt buydown again it gives the citizens a chance to participate in where they want this government to head. It will cause greater fiscal restraint on the part of Congress. That 10 percent will be off the table, so it will further exacerbate the spending difficulties and spending cuts we will be faced with.

We did it in Florida. We had a tremendous budget deficit of two some billion dollars to face that first year, not a deficit in the actual budget, but spending estimates versus anticipated income. We brought the numbers together. We balanced the budget. It worked fine, and nobody has had extreme difficulties in Florida as a result.

Mr. HOUGHTON. Thank you, Mr. Chairman.

Mr. CRANE. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman. I would like to thank the individual members of the panel for coming forward with what I think are a very solid set of ideas.

I would particularly like to comment, first of all, on Mr. Smith's proposal with regard to neutral cost recovery. As I campaigned around my district and got to know a lot of the small manufacturers who are internationally competitive, I became aware of how many resources they have to put in annually to stay ahead of the game by investing in capital equipment.

The only way that small, internationally competitive manufacturers in this country can remain competitive in this trade climate is through this kind of critical investment, and I think your bill would address that, and I think it is absolutely essential that we have a provision like this in the tax bill we do this year.

I appreciate Mr. Foley's comments amplifying on the debt buydown. I strongly support this proposal since it was introduced in the past by our colleague from Pennsylvania, Mr. Walker. I think you have done a very good job today of outlining some of the reasons why we need to empower the taxpayers to force us to reduce our spending, and I think this is a very powerful tool to do that, and I think it also needs to be very strongly considered as the part of any final tax package we do.

And, finally, I would like to particularly congratulate Mr. Souder, who has come forward with a set of ideas on how we can use the Tax Code to encourage charitable deductions, which are going to, in my view, provide some resources for social needs that are very critical and in a way that they will be very effectively delivered, far more effectively than they can in the welfare state.

I would like to say, sir, when you do introduce these bills, I would be welcome—happy to join you as a sponsor, and thank you very much.

Mr. CRANE. Are there any other members that have questions for the panel? Yes, Mr. Christensen.

Mr. CHRISTENSEN. I also wanted to thank this panel for their time. It has been very enjoyable to listen to positive things that we have heard today about the family, restoring the family, as Congressman Largent talked about.

But also, Congresswoman Roukema, as someone who has Boys Town in their district, the main Boys Town campus, it was very enjoyable to hear you set the record straight on this war of words that we have been hearing from a lot of people. And I just really appreciate your viewpoints toward that because whether you call it a youth hostel or a group home or orphanages, if you will, they have provided positive results—especially Boys Town—incredible, positive things that Father Val Peters has done. I would like to hear your comments on that a little bit more.

Mrs. ROUKEMA. I would like to point out and say what I tried to say in my opening statement that what we are really talking about here are generations of children under the present system that are growing up with such deprivation that many of us don't really want to acknowledge it, whether it is living in families of drug abuse or whether it is living in families with extreme economic deprivation and extreme poverty. We have to look at this issue from the perspective of what is happening to the children and what can we best do to serve those children.

I think it was unfortunate for anyone to fashion it as though we were tearing children out of the arms of loving mothers. That was not at all what the statement was meant to mean.

And certainly by focusing on a Boys Town or even on a Little Women and Jo's Boys—that hasn't been brought up, but it is a similar situation, although it is fictional. It was based at that time on real-life situations—that our concern is for the children.

Now, what we have not been forthright about is discussing the cost for such programs, and I think that deserves a full and essential debate, too. It is not as easy to say that those costs can be absorbed necessarily by private charities. I believe one of my colleagues alluded to that problem. But these are not irreconcilable conflicts. What we need is some honesty and sincerity of purpose in addressing it directly——

Mr. CHRISTENSEN. Thank you very much.

Mrs. ROUKEMA [continuing]. On behalf of the children.

Mr. CRANE. Are there any other members who have questions for the panel? Yes, Mr. Levin.

Mr. LEVIN. Just briefly, because Mr. Samuels is here.

Talking about Mr. Samuels, Mr. Smith, you are right. Mr. Samuels does not give your proposal a very warm embrace, and it might be useful if you might either for the record or just informally respond to it. You might send us a letter or whatever you would like. Because it is a fairly, I think, comprehensive analysis of it.

[The following was subsequently received:]

REP. NICK SMITH'S RESPONSE TO THE TREASURY DEPARTMENT'S CRITICISM OF NEUTRAL COST RECOVERY

CRITICISM: The Administration opposes neutral cost recovery because "it would encourage uneconomic investment and tax shelter activity..."

RESPONSE: Neutral cost recovery would not encourage uneconomic investment or could not be used for "tax sheltering" because it doesn't allow for deductions that are disproportionate to the amount of the investment. Instead of granting arbitrary deductions as an investment tax credit might, neutral cost recovery would allow businesses to deduct the full present value of their machinery or equipment. This depreciation schedule is called "neutral," because it would make deductions neutral in regard to inflation for both expensed and depreciated business purchases. Contrary to the Administration's claim, this legislation would actually allow business investment decisions to be based on economic considerations rather than tax penalties as under current law.

CRITICISM: The Clinton Adminstration claims that implementation of neutral cost recovery would reduce federal receipts by $120.4 billion over the eleven-year period, FY1995 - FY2005.

RESPONSE: The Department of Treasury uses a static economic model for these estimates. This method fails to take into account increased business and individual tax receipts that would result from economic growth. The economy would grow as a result of increased purchases of machinery, equipment and facilities. There is no disagreement that neutral cost recovery would lead to more of these purchases by lowering the cost. Under the dynamic model used by Gary Robbins, a former revenue estimator at the Treasury Department, neutral cost recovery would increase revenues by approximately 119 billion dollars over the next five years alone. If there is only ten percent of the economic expansion predicted by the dynamic model, revenues coming into the federal government will more than offset the losses predicted by the Treasury Department.

Mr. LEVIN. Also, there is an estimate of the revenue impact, and it very much varies from Mr. Robbins' estimate, and we are going to be getting into this. Do you have any idea how Mr. Robbins estimated the tax acts of 1981 at the time? Do you have any idea what he said about those?

Mr. SMITH OF MICHIGAN. Well, I suspect that Republicans and Democrat estimators have been somewhat consistently in error in the way we try to guess what is going to happen in the future. And that is why I briefly quoted Alan Greenspan when he said that we make our best estimate of what it might cost if you don't look at the dynamic effects and try to judge human behavior. And in the long run, if it is fair and if most of us agree that it is going to have a positive effect on jobs for our kids, then we should go ahead and do it.

Mr. LEVIN. That is what he said this morning?

Mr. SMITH OF MICHIGAN. That is what Mr. Greenspan said. I will send you a transcript of his response to me this morning when I asked him that question.

[The following was subsequently received:]

Mr. SMITH OF MICHIGAN. Mr. Chairman, thank you.

Dr. Greenspan, thank you for having—giving me the opportunity to ask you this question. What appears to me a more dramatic difference, and probably will be the decision on whether or not my bill that I introduced last session and again this session on neutral cost recovery passes, is the interpretation of the benefits and the disadvantages to revenue.

Essentially, neutral cost recovery is a tax policy that fairly taxes the real return on capital—in this case, a return that neutralizes the loss from inflation. It seems, in order to encourage businesses to invest in machinery and equipment, we need to stop penalizing businesses for making those kinds of investments; and I understand today Treasury is going to come up with their static analysis of what it is going to cost over the next 5, 10, whatever years.

And also I have a report from Gary Robins, a former Treasury estimator, that says a quite different story of what the results would be, very briefly, and then get your reaction. He is guessing that it would reduce the cost of those purchases by 16 percent, and that would increase the purchases. It would result in 2.7 million new jobs; it would increase take-home pay by around $3,300; essentially increase economic activity by the year 2000 by 3.5 trillion, compared to the tens of billions of dollars that it is going to cost, according to Treasury, and the difference that—the dramatic difference in the benefits of this policy. How does Congress make the decision whether or not it is a good policy?

Mr. GREENSPAN. Mr. Smith, this is basically the type of issue which I think is best addressed by what I indicated before, perhaps getting more individual policy initiatives such as this, calling groups of experts periodically from all sides of the issue with staff to sit down and go over the specific procedures. One of the problems we have, which I think that has been of great concern to a number of people, is that all too often we are dealing with a time frame in which estimates of various programs have got to be quick. You have got to know, when somebody brings up an amendment and you have to know within 24 hours what it costs, or 48 hours or something like that.

There are a number of initiatives, especially those which differ from the usual type of budgetary initiatives, which really cannot be scored easily or evaluated easily. And when they are important issues, it is crucial to get a number of people who have looked at them to see whether in fact firmer estimates can be made of what the impact of various policies are—not for official scoring purposes, because you probably can't do that in the time frame involved, but you do need it to make judgments about policies. And I suspect, as I indicated in my prepared remarks, that there are a number of policies which probably deserve to go forward in this Congress in the budget, which probably are unfairly scored in any objective sense.

But if they are important policies and they look as though they have great potential, my own judgment is it is probably wise to go forward with those policies and take the scoring hits on the grounds that it is unfortunate, but you may have a policy which really should move forward. And I would not allow the process of budget-making to be driven solely by official scoring, because the one thing we are sure of in that system is that it is deficient and it biases choices.

It is useful, and as I indicated to Charlie Stenholm, I think it is working in a remarkably effective way, considering how deficient it is as a structure. And I would be hesitant to change it, but I would not be hesitant to start looking at other procedures which enable us to look at more dynamic approaches, more imaginative approaches, to evaluating whether or not a particular policy option is something which should move forward in the budget process.

STATEMENT OF ALAN GREENSPAN, CHAIRMAN, FEDERAL RESERVE BOARD OF GOVERNORS

Mr. GREENSPAN. Thank you very much, Mr. Chairman. I am especially pleased to appear here today to address some of the most important issues involved in producing the budget of the U.S. Government. The views I will be expressing are my own and not necessarily those of the Federal Reserve Board.

The budget process has improved significantly in recent years. The caps on discretionary spending and the pay-as-you-go rules have restrained deficit-expanding programs far better than many had anticipated. Budget scoring is crucial to this process. Unless estimates of the outlays and revenues from budget initiatives are credible, the current system cannot work effectively. This joint hearing of the Congress' Budget Committees, unprecedented in my experience, attests the importance of budget scoring.

Accurate estimates of the effects on tax and spending policy on the budget are difficult to make, some more than others as the previous panel I am sure has expounded on at great length. In particular, concern has been raised that current methods are too "static." As these other witnesses have indicated, current scoring procedures already allow for some response in the spending, saving, and investment behavior of individuals and firms. Indeed, although it is difficult to measure, the budget scoring process has become increasingly dynamic over the years and estimating techniques have improved.

What is still generally not taken into account, however, is the effect of fiscal initiatives on macroeconomic variables like GDP, total labor compensation, and aggregate investment. Concerns that current estimating procedures do not fully track the effect of changes in behavior on aggregate economic activity and hence on overall budget receipts and outlays are obviously justified.

The current method is admittedly incomplete, especially for policy initiatives with broad economic impacts. One central issue with respect to a more dynamic scoring is whether cyclical aggregate demand effects of fiscal changes should be taken into account or only permanent effects on aggregate supply. There are a number of ways of looking at this, but I would suggest that including aggregate demand effects would be confusing, if not misleading, in many if not most contexts. Among other things, the scope for realizing such demand effects on economic activity would be a function of the particular phase of the business cycle and could be viewed in a sense as transitory. Particularly when we are addressing the problem of the long-run structural deficit, the focus should be on how fiscal actions affect the potential of the economy to produce greater output and taxable income on a sustained, ongoing basis. Thus, if a more dynamic scoring were to be adopted, I would recommend limiting the analysis to appropriate supply-side effects.

Apart from that consideration, full dynamic estimates of individual budget initiatives should be our goal. Unfortunately, the analytical tools required to achieve it are deficient. In fact, the goal ultimately may be unreachable. The estimation of full dynamic effects requires a model that both captures micro- and macroeconomic processes and produces reliable, long-term forecasts of economic outcomes.

Unfortunately, no such model exists. Indeed, no model currently in use can predict macroeconomic developments without substantial ad hoc adjustments that effectively override the internal structure of the model. We should not assume that models can capture the long-run dynamic effects of specific tax and outlay changes any better than they can forecast the economy.

Even current procedures require relatively sophisticated techniques to determine the budget consequences of particular tax and outlay programs. Changes in the tax structure alter economic incentives in ways that may be extraordinarily complex. For entitlement programs, one has to assess, for example, how greater public awareness of the existence of such a program will affect participation, and how behavior will change to take advantage of the entitlement. The disappointing history of projections for Medicare and Medicaid attests to the difficulty of pinning down such consequences.

The assumptions required for realistic estimates, in many instances, constitute little more than informed guesses, largely because accurate information is scarce and our understanding of human behavior is limited. Not surprisingly, objective analysts often reach quite different conclusions about the impact of a specific outlay or tax program, even without trying to trace the feedback effects on the budget estimates from resulting changes in GDP and other macroeconomic variables.

This does not mean we have no judgments about the dynamic effect of various policy proposals. Martin Feldstein and others have already made useful contributions to our understanding of the long-run effects of the tax structure on work, saving, and Federal revenues. Thus, we may know, or suspect, the direction of a long-term response. But our knowledge of its magnitude and timing is imprecise.

For example, although the empirical evidence is admittedly mixed, I strongly suspect that the elimination of, or a major reduction in, the rate of taxation on capital gains would entail little, if any, loss of total revenues over the long run. However, it is currently not possible to estimate with any degree of precision the impact of such a proposal on the deficit within the horizon of the current budget process.

If, as many advocate, outlays are reduced well below current service levels in the years ahead, the debate over scoring is likely to move off center stage. This will occur because the outlay cuts will free up significant revenues for tax cuts, regardless of whether the current or a more dynamic scoring is employed.

And if total revenues turn out to be greater than current procedures project, deficits will trend lower than estimated. If we inadvertently produce a budget surplus by such miscalculations, the implications will be positive for long-run economic growth. More to the point, if we fail to achieve adequate reductions in outlays, budget scoring will not substitute for hard political choices.

Clearly our political process has a bias toward deficit spending. Accordingly, we should be especially cautious about adopting technical scoring procedures that might be suspectable to overly optimistic assessments of the budgetary consequences of fiscal actions. Currently, real long-term interest rates remain relatively high, partly because of the expected growth of budget deficits later in this decade and thereafter.

Upward revisions to market expectations of deficits resulting from a perception that tax and outlay choices are being driven by optimistic scoring would only exacerbate this trend with negative consequences for financial stability and economic growth.

In current circumstances, the risks of more conservative assessments which might overstate the loss in revenues, for example, seem modest. Moreover, should the budget deficit turn out smaller than expected, the resultant favorable effect on real interest rates would tend to stimulate private investment.

We must avoid resting key legislative decisions on controversial estimates of revenues and outlays. Should financial markets lose confidence in the integrity of our budget scoring procedures, the rise in inflation premiums and interest rates could more than offset any statistical difference between so-called static and more dynamic scoring.

In summary, the current relatively straightforward scoring system has served us well in many regards. In particular, its very straightforwardness may limit the possibilities for major estimating differences. Nevertheless, current scoring does fail to reflect potentially important long-term structural supply-side benefits and, accordingly, unfavorably biases the choice of fiscal programs.

At a minimum, these supply-side effects should be estimated. Thus, even if not officially scored, they might influence policy choices. The Congress may choose to pass a tax cut with highly favorable supply-side effects on the economy and be willing to cut spending to accommodate it. In any event, in the longer run, we should seek to find a way to embody such effects in our official scoring.

Let me reiterate that, although scoring is a major factor in the budget process, process does not mean much if real deficit control is not achieved. I do not intend to get into the deeper programmatic issues involved in deficit reduction and I probably could not add very much to the knowledge of these committees in that regard. I would, however, like to comment briefly on the sensitivity of deficits to the particular cost-of-living measure used to index entitlement programs and the income tax structure.

Many difficulties have arisen in the past and doubtless will continue to arise in the future. For example, as you may know, the Bureau of Labor Statistics made a significant change in how it calculates the Consumer Price Index in 1983, when it shifted from a method in which the price index for housing was constructed as if each household was paying the current home price and mortgage rate on its residence to one that is a more realistic measure of the cost of home occupancy.

Because of the run-up in house prices and interest rates between the late 1960's and early 1980's, the official CPI rose about 9 percent more than indicated by the newer, superior measure. By the time the index was changed, this overstatement had added substantially to the level of outlays in the large indexed Federal programs—Social Security, SSI, veterans' pensions, military retirement, and civilian pensions. Once the additional interest outlays required to finance the cumulatively higher Federal debt are added in, a rough estimate suggests that, all else equal, the deficit for fiscal 1994 would have been smaller by $50 billion had the overindexing not occurred.

Although, obviously, little can be done to remedy the errors of the past, greater efforts should be made in the future to ensure that the indexing of spending and tax programs accurately reflects trends in the cost of living. In that regard, concerns have been raised that, for a variety of reasons, the official CPI may currently be overstating the increase in the true cost of living by perhaps .5 to 1.5 percent per year.

To be sure, the overstatement may be a little less for retirees whose spending patterns differ from those of younger age groups and who are the main recipients of indexed Federal benefits. But even for this group, it doubtless remains significant.

Thus, when the Congress reviews the methods of indexing spending programs and taxes, attention should be given to the biases in the price indexes that are used. Removing the bias in the CPI would have a very large impact on the deficit. For example, if the annual inflation adjustments to indexed programs and taxes were reduced by one percentage point—and making the admittedly strong assumption that there are no other changes in the economy—the level of the deficit will be lower by about $55 billion in the fifth year, including the effects of lower debt levels. The cumulative 5-year savings, I might add, would approximate $150 billion.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Greenspan follows:]

PREPARED STATEMENT OF ALAN GREENSPAN, CHAIRMAN, FEDERAL RESERVE BOARD OF GOVERNORS

I am pleased to appear here today to address some of the most important issues involved in producing the Budget of the United States Government. The views I will be expressing are my own and not necessarily those of the Federal Reserve Board.

The budget process has improved significantly in recent years. The caps on discretionary spending and the pay-as-you-go rules have restrained deficit-expanding programs far better than many had anticipated. Budget scoring is crucial to this process. Unless estimates of the outlays and revenues from budget initiatives are credible, the current system cannot work effectively. This joint hearing of the Congress's budget committees, unprecedented in my experience, attests to the importance of budget scoring.

Accurate estimates of the effects of tax and spending policies on the budget are difficult to make, some more than others. In particular, concern has been raised that current methods are too "static." As other witnesses have indicated, current scoring procedures already allow for some response in the spending, saving, and investment behavior of individuals and firms. Indeed, although it is difficult to measure, the budget scoring process has become increasingly dynamic over the years, and estimating techniques have improved. What is still generally not taken into account, however, is the effect of fiscal initiatives on macroeconomic variables like GDP, total labor compensation, and aggregate investment. Concerns that current estimating procedures do not fully track the effects of changes in behavior on aggregate economic activity, and hence on overall budget receipts and outlays, are justified. The current method is admittedly incomplete, especially for policy initiatives with broad economic impacts.

One central issue with respect to a more dynamic scoring is whether cyclical, aggregate demand effects of fiscal changes should be taken into account--or only permanent effects on aggregate supply. There are a number of ways of looking at this, but I would suggest that including aggregate demand effects would be confusing, if not misleading, in many contexts. Among other things, the scope for realizing such demand effects on economic activity would be a function of the particular phase of the business cycle and could be viewed in a sense as transitory. Particularly when we are addressing the problem of the long-run structural deficit, the focus should be on how fiscal actions affect the potential of the economy to produce greater output and taxable income on a sustained, ongoing basis. Thus, if a more dynamic scoring were to be adopted, I would recommend limiting the analysis to appropriate supply-side effects.

Apart from that consideration, full dynamic estimates of individual budget initiatives should be our goal. Unfortunately, the analytical tools required to achieve it are deficient. In fact, the goal ultimately may be unreachable. The estimation of full dynamic effects requires a model that both captures micro- and macroeconomic processes and produces reliable long-run forecasts of economic outcomes. Unfortunately, no such model exists. Indeed, no model currently in use can predict macroeconomic developments without substantial ad hoc adjustments that effectively override the internal structure of the model. We should not assume that models can capture the long-run dynamic effects of specific tax and outlay changes any better than they can forecast the economy.

Even current procedures require relatively sophisticated techniques to determine the budget consequences of particular tax and outlay programs. Changes in the tax structure alter economic incentives in ways that may be extraordinarily complex. For entitlement programs, one has to assess, for example, how greater public awareness of the existence of such a program will affect participation, and how behavior will change to take advantage of the entitlement. The disappointing history of projections for Medicare and Medicaid attests to the difficulty of pinning down such responses. The assumptions required for realistic estimates, in many instances, constitute little more than informed guesses, largely because accurate information is scarce and our understanding of human behavior is limited. Not surprisingly, objective analysts often reach quite different conclusions about the impact of a specific outlay or tax program, even without trying to trace the feedback effects on the budget estimates from resulting changes in GDP and other macroeconomic variables.

This does not mean we have no judgments about the dynamic effect of various policy proposals. Martin Feldstein and others have already made useful contributions to our understanding of the long-run effects of the tax structure on work, saving, and federal revenues. Thus, we may know, or suspect, the direction of a long-run response. But our knowledge of its magnitude and timing is imprecise. For example, although the empirical evidence is admittedly mixed, I strongly suspect that the elimination of, or a major reduction in, the rate of taxation on capital gains would entail little, if any, loss of total tax revenue over the long run. However, it is currently not possible to estimate with any degree of precision the impact of such a proposal on the deficit within the horizon of the current budget process.

If, as many advocate, outlays are reduced well below current service levels in the years ahead, the debate over scoring is likely to move off center stage. This will occur because the outlay cuts will free up significant revenues for tax cuts, regardless of whether the current or a more dynamic scoring is employed. And, if total revenues turn out to be greater than current procedures project, deficits will trend lower than estimated. If we inadvertently produce a budget surplus by such miscalculations, the implications will be positive for long-run economic growth. More to the point, if we fail to achieve adequate reductions in outlays, budget scoring will not substitute for hard political choices.

Clearly, our political process has a bias toward deficit spending. Accordingly, we should be especially cautious about adopting technical scoring procedures that might be susceptible to overly optimistic assessments of the budgetary consequences of fiscal actions. Currently, real long-term interest rates remain relatively high, partly because of the expected growth of budget deficits later in this decade and thereafter. Upward revisions to market expectations of deficits resulting from a perception that tax and outlay choices were being driven by optimistic scoring would only exacerbate this trend, with negative consequences for financial stability and economic growth. In current circumstances, the risks of more conservative assessments, which might overstate the loss in revenues, for example, seem modest. Moreover, should the budget deficit turn out smaller than expected, the resultant favorable effect on real interest rates would tend to stimulate private investment.

We must avoid resting key legislative decisions on controversial estimates of revenues and outlays. Should financial markets lose confidence in the integrity of our budget scoring procedures, the rise in inflation premiums and interest rates could more than offset any statistical difference between so-called static and more dynamic scoring.

In summary, the current, relatively straightforward scoring system has served us well in many regards. In particular, its very straightforwardness may limit the possibilities for major estimating differences. Nevertheless, current scoring does fail to reflect potentially important long-term structural supply-side benefits, and accordingly unfavorably biases the choice of fiscal programs. At a minimum, these supply-side effects should be estimated. Thus, even if not officially scored, they might influence policy choices. The Congress may choose to pass a tax cut with highly favorable supply-side effects on the economy and be willing to cut spending to accommodate it. In any event, in the longer run, we should seek to find a way to embody such effects in our official scoring.

Let me reiterate that, although scoring is a major factor in the budget process, process does not mean much if real deficit control is not achieved. I do not intend to get into the deeper programmatic issues involved in deficit reduction--and I probably could not add very much to the knowledge of these committees in that regard. I would, however, like to comment briefly on the sensitivity of deficits to the particular cost-of-living measure used to index entitlement programs and the income tax structure. Many difficulties have arisen in the past and doubtless will continue to arise in the future. For example, as you may know, the BLS made a significant change in how it calculates the CPI in 1983, when it shifted from a method in which the price index for housing was constructed as if each household was paying the current home price and mortgage rate on its residence to one that is a more realistic measure of the cost of home occupancy. Because of the run-up in house prices and interest rates between the late 1960s and early 1980s, the official CPI rose about 9 percent more than indicated by the newer, superior measure. By the time the index was changed, this overstatement had added substantially to the level of outlays in the large indexed federal programs--social security, SSI, veterans' pensions, military retirement, and civilian pensions. Once the additional interest outlays required to finance the cumulatively higher Federal debt are added in, a rough estimate suggests that, all else equal, the deficit for FY1994 would have been smaller by $50 billion had the overindexing not occurred.

Although little can be done to remedy the errors of the past, greater efforts should be made in the future to ensure that the indexing of spending and tax programs accurately reflects trends in the cost of living. In that regard, concerns have been raised that, for a variety of reasons, the official CPI may currently be overstating the increase in the true cost-of-living by perhaps 1/2 percent to 1-1/2 percent per year. To be sure, the overstatement may be a little less for retirees, whose spending patterns differ from those of younger age groups and who are the main recipients of indexed federal benefits. But even for this group, it doubtless remains significant. Thus, when the Congress reviews the methods of indexing spending programs and taxes, attention should be given to the biases in the price indexes that are used. Removing the bias in the CPI would have a very large impact on the deficit. For example, if the annual inflation adjustments to indexed programs and taxes were reduced by 1 percentage point--and making the admittedly strong assumption that there are no other changes in the economy--the annual level of the deficit will be lower by about $55 billion after five years, including the effects of lower debt levels.

Mr. LEVIN. So we simply go ahead, everybody guessing the best they can?

Mr. SMITH OF MICHIGAN. The Budget Committee was having a hearing on whether we should consider moving closer to dynamic scoring as opposed to static scoring in light of what happened to revenue when Congress put a tax on the wealthy and the boat industry, et cetera, and his reaction was that maybe we wouldn't change the scoring but at least we should acknowledge and take into account the fact that that scoring can't accurately determine what is going to happen in the future. And if we use that static scoring, we, as a Congress, have to help analyze what is good and what is fair and what we think is going to be good for the future of our economy.

Mr. LEVIN. All right, thank you. Thank you very much.

By the way, Mrs. Roukema, it will be interesting to see the later analyses of the New Jersey study.

I will finish by asking you, if the New Jersey study a year or two from now showed there wasn't any discernible impact, what would your position be about the experiment in New Jersey?

Mrs. ROUKEMA. In the first place, I do think one has to look at this over time, and I think I tried to state that in the full text of my statement. Two years' experience is not adequate. Nor do I think 1 more additional year could be adequate. But it would have to be evaluated over time.

I do want to stress, however, that that proposal was taken from the U.S. Commission's lengthy study of the issue, and the Commission was not a political commission. It was not only bipartisan, but it was made up primarily of experts in the field, child development experts, poverty experts and a whole range of people that are familiar with the problems of child support enforcement nationally.

There were only three elected officials on the Commission—Senator Bradley, our colleague Congresswoman Kennelly and myself—and it was the unanimous recommendation of that committee that this be part of the reform effort.

Mr. LEVIN. Thank you.

Mr. CRANE. Are there any other questions?

If not, I want to express appreciation to all the panelists, too, for your presentations and your insights. And we will adjourn this panel and then ask Mr. Samuels, who as I understand is here, to come forth and testify.

Chairman ARCHER [presiding]. We would be pleased to have you take the witness chair. I am delighted to welcome Les Samuels, Assistant Secretary of the Treasury for Tax Policy, as our next witness.

This committee, of course, is always very, very interested in hearing what the Treasury has to say relative to the deliberations before us, and at such time as you are ready you may proceed with your testimony. I understand you have a rather lengthy written statement that you would like to insert in the record but that you have a shorter oral statement that you would like to make. Is that correct?

Mr. SAMUELS. Mr. Chairman, if I may, I do have a longer statement for the record, and I would like to summarize it, if I may.

Chairman ARCHER. Without objection, your complete statement will be inserted in the record, and we are prepared to hear from you on whatever you would like to tell us.

Mr. SAMUELS. Thank you.

STATEMENT OF HON. LESLIE B. SAMUELS, ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. SAMUELS. Mr. Chairman and members of the committee, I am pleased to appear before this committee today to present the administration's views on the tax proposals in the series of bills referred to as the Contract With America. The Contract raises broad issues of public policy concerning the proper size and scope of Federal governmental activity, the allocation of Federal budgetary resources, and the division of responsibilities between the Federal and State governments. In addition, the Contract contains several broad proposals, such as the proposed balanced budget amendment that could indirectly have a major impact on the Federal tax system. These broad issues are beyond the scope of my testimony today, which will focus on the tax and tax-related provisions in the Contract and their tax policy implications.

We look forward to working with this committee to develop and refine tax proposals that encourage economic growth and improve the lives of working Americans. We are particularly interested in crafting proposals that are affordable, simple, efficient, and focused on middle-income families. We must build on the progress we have made over the past 2 years. We have achieved a remarkable combination of high employment, high economic growth, and low inflation. In the last Congress, we worked on a bipartisan basis with this committee to pass NAFTA and GATT.

There are a number of proposals in the Contract where there is common ground, but we are particularly concerned about the capital gains and what is described as "neutral cost recovery proposals." These proposals, if enacted, would result in significant tax shelter transactions and encourage investment in uneconomic activities. Nevertheless, we are confident that together we can develop targeted proposals that are acceptable to the Congress, the President, and the American people.

There are 15 tax and tax-related proposals in the Contract. They range from tax credits for children and a savings incentive to capital gains preferences and a cost recovery system. Before I discuss a few of these, I want to offer an overview of the tax policy implications of the Contract.

We are very concerned about the potential effect of the Contract on the deficit. This administration, with the assistance of the previous Congress, has made significant progress in controlling spending and reducing the deficit. In the last fiscal year, the deficit was at its lowest level relative to the gross domestic product in the past 5 years and the second lowest in the past 13 years. Moreover, our unemployment rate has dropped to 5.4 percent, and inflation last year was below 3 percent.

We have prepared preliminary revenue estimates, shown in table 1, that reflect changes made to the Contract in bills introduced last week. There is a chart on the board there. Our preliminary analysis shows that the proposed tax cuts in the Contract With America would lose $205.4 billion over the period fiscal year 1995 through fiscal year 2000. As you can see, the revenue cost grows rapidly after fiscal year 2000, to almost $120 billion per year, raising the fiscal year 1995 to fiscal year 2005 revenue cost to $725.5 billion. Thus, the tax provisions in the Contract would increase the deficit unless they are fully and permanently offset by specific financing proposals.

We learned an important lesson in the eighties: The responsible thing to do is to make certain that tax cuts and spending increases are paid for at the outset.

Our evaluation of the tax proposals in the Contract is based on three basic principles of tax policy: Fairness, simplicity, and efficiency. We are concerned that several provisions in the Contract do not fully satisfy these criteria. In particular, they would provide disproportionate benefits to high-income taxpayers; would make the law more complicated; and would encourage unproductive tax shelter activity.

The first of these basic principles of tax policy is fairness. An important dimension of tax fairness is the distribution of the tax burden among families at different income levels. Fifty percent of the tax benefits from the Contract would go to families with incomes over $100,000. The most well off in America, the richest Americans, get half of the benefits of the tax cuts contained in the Contract. That does not meet the fairness test. In fact, it reduces the progressivity of the Federal tax system.

Simplicity is also a tax policy goal by which the Contract should be evaluated. To the extent consistent with other tax policy goals, the income tax should be designed to minimize the cost of compliance by taxpayers and the administrative costs of the Internal Revenue Service. Several of the proposals may appear simple at first glance, but as I will point out in a moment, a great deal of complexity must be introduced in order to implement the proposals and administer them. If this is not done, arbitrary and unfair distinctions are created which also provide opportunities for abuse.

Finally, the tax system should be efficient. It should interfere as little as possible in the economic decisions of investors, workers, and consumers. The tax system should not encourage investment in uneconomic activities. In the early eighties we experienced a proliferation of tax shelter activity, with very adverse results, both for investors and the tax system. We must not repeat that experience.

I would now like to go over some of the provisions in the Contract.

The administration supports a $500-per-child tax credit for middle-income families. And I would point out that Congress passed a child tax credit in 1992, but it was vetoed. We believe that the Contract proposal would be improved if modified along the lines of the President's proposal. The Contract proposal provides benefits for families with an adjusted gross income up to $250,000, more than 99 percent of all families. The President's proposal is targeted to middle-income families.

American dream savings accounts, or ADSAs, are designed to provide an incentive to individuals to increase their savings. We support this goal for middle-income families. We believe the Contract proposals, again, would be improved if targeted to these families.

A quick word here on savings. Our national savings rate is abysmally low. If we do not get the rate up, it will be hard to sustain private investment into the next century. That could endanger the continued healthy growth of the economy. We believe that expanding and improving the traditional deductible IRA is the most effective way to promote new savings.

In this regard, the President's proposal is similar to the IRA bill cosponsored by Mr. Thomas and passed by Congress in 1992. Backloaded proposals, like ADSA, can supplement expansion of deductible IRAs, but we do not believe the ADSAs are effective as a stand-alone. I would also note the Contract proposes penalty-free withdrawals from ADSAs for first home purchases, education, and other purchases. We feel those same benefits should be available for IRAs.

Finally, the Contract proposal fails to target its benefit to those most likely to increase savings. As a result, it is less cost effective than the President's proposal.

The administration supports an increase in the expensing limit for small business, which the House passed in 1993 with the administration's support. Last year, the administration proposed legislation on the tax treatment of long-term care, insurance, and services, as well as accelerated death benefits under life insurance. We generally support these proposals in the Contract, but believe they should be modified to protect policyholders and to prevent tax abuse that could occur under the Contract's proposals.

The administration opposes the proposed cost recovery system. Its generous benefits could divert dollars from investment that improve productivity to investments that yield significant tax benefits. The CRS could lead to a proliferation of tax shelters, like the see-through buildings we experienced in the last decade. In addition, indexing the basis of assets for inflation plus a 3.5-percent return without also indexing debt effectively allows businesses to earn tax-free income and fully deduct the cost of funds used to produce that income. In essence, CRS could revive the tax shelter abuses of the eighties.

Let me give you a simple example, and it is up there on the board. A business buys a machine for $1,000. Instead of depreciating the $1,000 cost, as permitted under current law, the taxpayer under the CRS proposal would be entitled to total depreciation deductions of $1,380, assuming 3 percent inflation. In addition, the taxpayer will be allowed to deduct all of the interest on money borrowed to buy the equipment. It is a better deal than buying a tax-exempt bond. The taxpayer, as you can see, has a negative income tax.

We are very concerned about the revenue loss from this proposal. While it is structured to raise $18.4 billion through fiscal year 2000, it loses $138.8 billion over the second 5-year period. As a result of the CRS, some large corporations may not pay either corporate income tax or alternative minimum tax. This would be a major retreat from tax reform enacted in 1986. I think Americans would be concerned if we gave such a large benefit to business when it is middle-income taxpayers who need our help.

With respect to capital gains tax, the administration opposes the 50-percent exclusion and the indexing proposal. The combination of a 50-percent exclusion plus indexing is too generous, too complex, and not well targeted. The administration's 1993 capital gains exclusion that would be repealed by the Contract is limited to new investments and, thus, does not provide a windfall benefit to existing assets. It is also limited to small businesses, thus reducing the cost of equity capital to those businesses that are most likely to find it difficult or costly to obtain financing.

We believe that additional capital gains preferences for new investment, if they are determined to be necessary, should likewise be targeted and should meet the tests of fairness, simplicity, and efficiency.

I want to say just a quick word about indexing of capital gains, that is, taxing only the amount of profit that exceeds the cumulative inflation rate. Most Americans want to do less paperwork, not more, and that holds doubly so when you are talking about taxes. But that is not what will happen if you start requiring people to keep new detailed records on every home improvement and the same holds true for people who own stock or mutual funds. The recordkeeping burden really begins to pile up. This, in fact, could be a tax lawyer's and accountant's dream, but a homeowner's and small investor's nightmare.

On top of that, with quarterly inflation adjustments, investors will wait until the end of each quarter to sell, looking for that little inflation bump to reduce the tax they owe. You know, to keep that from happening, you probably have to put out a figure much more frequently. Think about the recordkeeping problems and the market inefficiencies this creates.

The indexing proposal permits investors to claim a tax loss when their investments do not keep up with inflation, even though they are able to sell the investments for more than the original purchase price. So if you buy an investment, the inflation value goes up, you sell it for more than your original purchase price, but less than the inflation adjustment, you get a tax loss.

In addition, since borrowings, and this is a very important point, since borrowings are not indexed, taxpayers would have a tax incentive to finance investments with debt. Overall, you can see how this indexing proposal would encourage tax shelter activity.

Next, the administration opposes the phaseout of the 85-percent maximum inclusion rate for Social Security because it would reduce revenues for the HI Trust Fund. Moreover, under current law, Social Security benefits generally receive more favorable treatment than do pension and other retirement income. The OBRA 1993 increase affects only 13 percent of taxpayers reporting Social Security benefits, those at the high end of the income distribution of beneficiaries. The OBRA 1993 changes did not affect the other 87 percent of taxpayers receiving benefits.

The proposed tax credit to reduce marriage penalties lacks detail on the allocation of benefits and would be difficult to administer. The administration would prefer to work with the Congress to investigate other means of addressing this issue.

With respect to an income tax checkoff for deficit reduction, the administration has a strong commitment to deficit reduction and supports the goal of this proposal. The idea is to impose discipline on spending by the Federal Government and, in doing so, reduce the amount of outstanding Federal debt. But the administration opposes this particular proposal because of the impact it could have on the legislative process, the budget process, and the economy.

The proposal would allow certain individuals effectively to override congressional choices by extending to those designating a transfer to the trust fund the right permanently to reduce the level of Federal spending. Those with high income tax liabilities would have a greater say in how Federal funds are spent. Those with low-income tax bills or with only payroll or excise tax liabilities would, in effect, be disenfranchised.

This proposal undermines the fundamental tenet of our political system, one person, one vote.

The administration supports the goal of reducing regulatory burdens to the extent compatible with responsible administration of the laws. Nevertheless, the administration and the prior two administrations have recognized that a one-size-fits-all approach to regulations is not in the best interest of the government or the public. The Contract provisions would apply to tax regulations. It is important to consider the consequences, and we would very much like to work with the committee on this critical issue.

The Contract would have a very negative impact on the tax guidance and administrative process. Without regulatory clarification of statutory issues, individuals and businesses would be subject to uneven enforcement of the tax laws. They would be denied the certainty that they need to plan for long-term investments and would be hesitant to engage in productive economic activities. We strive in tax policy for uniform administration of the tax laws and regulatory standards are essential.

The prior administration also recognized the critical role of tax regulations during the 1992 regulatory moratorium and allowed the IRS to continue to issue tax regulations on a regular basis.

In conclusion, the administration has serious reservations about some of the provisions in the Contract but we share the goals that would be advanced by other provisions. The administration is interested in crafting a set of tax cut proposals that are affordable, simple, efficient, and focused on middle-income families, as the President has done in the Middle-Class Bill of Rights.

We look forward to working with the committee to develop proposals that meet these criteria and which are acceptable to the Congress, the President, and the American people.

That concludes my statement and I will be pleased to answer any questions that you may have.

[The prepared statement and attachments follow:]

STATEMENT OF LESLIE B. SAMUELS
ASSISTANT SECRETARY (TAX POLICY)
BEFORE THE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and distinguished Members of the Committee:

I am pleased to appear before this Committee today to present the Administration's views on the tax proposals in the series of bills collectively referred to as the "Contract with America."[1] The Contract raises broad issues of public policy concerning the proper size and scope of Federal government activity, the allocation of Federal budgetary resources, and the division of responsibilities between the Federal and State governments. In addition, the Contract contains several broad proposals, such as the proposed balanced budget amendment, which could indirectly have a major impact on the Federal tax system. These broad issues are beyond the scope of my testimony today, which will focus on the tax and tax-related provisions in the Contract and their tax policy implications.

There are fifteen tax and tax-related proposals in the Contract. The tax proposals are: (1) a $500 per child refundable tax credit; (2) the "American Dream Savings Account;" (3) favorable tax treatment for long-term care insurance and services; (4) tax-free accelerated

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[1] These bills include H.R. 2, the "Fiscal Responsibility Act," H.R. 3, the "Taking Back Our Streets Act," H.R. 4, the "Personal Responsibility Act," H.R. 5, the "Unfunded Mandate Reform Act," H.R. 6, the "American Dream Restoration Act," H.R. 7, the "National Security Restoration Act," H.R. 8, the "Senior Citizens' Equity Act," H.R. 9, the "Job Creation and Wage Enhancement Act," H.R. 10, the "Common Sense Legal Reforms Act," and H.R. 11, the "Family Reinforcement Act."

death benefits under life insurance policies; (5) an increased expensing limit for small businesses; (6) a $5,000 refundable tax credit for adoption expenses; (7) a $500 refundable tax credit for elderly care; (8) the "neutral" cost recovery system; (9) capital gains tax preferences; (10) phase out of the 85 percent maximum inclusion rate for Social Security benefits; (11) a tax credit to reduce marriage penalties; (12) expansion of the home office deduction; and (13) an increase of the estate tax exemption to $750,000.[2] The two tax-related proposals in the Contract are: (14) an income tax return check-off for deficit reduction; and (15) regulatory reform.[3] Before addressing each of these proposals in detail, I will provide an overview of the tax policy implications of the Contract.

We look forward to working with this Committee to develop and refine tax proposals to encourage further economic growth and improve the lives of working Americans. We are particularly interested in crafting proposals that are affordable, simple, efficient, and focused on middle-income families. We must build on the progress we have made in the last two years. We have achieved a remarkable combination of high employment, high economic growth, and low inflation. Over the course of the last two years we have worked on a bipartisan basis with this Committee to pass NAFTA and GATT. There are a number of proposals in the Contract where there is common ground. But we are particularly concerned about the capital gains and cost recovery proposals. These proposals, if enacted, could stimulate the renewal of tax shelters and encourage investment in uneconomic activities. Nevertheless, we are confident that together we can develop proposals that are targeted to middle-income Americans and are acceptable to the Congress, the President, and the American people.

One of our primary concerns relates to the potential effect of the Contract on the deficit. This Administration, with the assistance of the previous Congress, has made significant progress in controlling Federal spending and in reducing the Federal deficit, which in the last fiscal year was at its lowest level relative to GDP in the past five years, and the second lowest in the past thirteen years. Furthermore, the Administration is proposing additional expenditure cuts that will fully pay for the tax cuts proposed in the President's "Middle Class Bill of Rights."

We have prepared preliminary revenue estimates of the tax provisions in the Contract based on the bills introduced on January 4, 1995. These estimates are preliminary because we have had only a short time to analyze the bills in their current form, and there have been

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[2] Proposals 1, 2, and 11 appear in H.R. 6, the "American Dream Restoration Act," proposals 3, 4, and 10 appear in H.R. 8, the "Senior Citizens' Equity Act," proposals 5, 8, 9, 12, and 13 appear in H.R. 9, the "Job Creation and Wage Enhancement Act," and proposals 6 and 7 appear in H.R. 11, the "Family Reinforcement Act."

[3] These two tax-related proposals appear in H.R. 9, the "Job Creation and Wage Enhancement Act."

significant changes in some of the provisions of the Contract since the original legislation was released on September 27, 1994. According to these preliminary revenue estimates, shown in Table 1, the tax cuts proposed in the Contract with America would lose $205.4 billion over the period FY1995 - FY2000. The revenue cost grows rapidly after FY2000, to nearly $120 billion per year in FY2005, raising the FY1995 - FY2005 revenue cost to $725.5 billion. Although the Contract proposes a balanced budget amendment, it does not contain specific proposals for expenditure reductions or tax changes necessary to achieve that balance or to offset the proposed tax cuts or pay for other provisions, such as increased defense expenditures, that would further increase the deficit. Thus, the tax provisions in the Contract would increase the deficit unless they are fully and permanently offset by specific financing proposals.

We believe that the tax proposals in the Contract should be evaluated according to three basic principles of tax policy: fairness, simplicity, and efficiency. Several provisions in the Contract, in their present form, do not fully meet these criteria.

A basic principle of tax policy is fairness. One dimension of tax fairness is the distribution of the tax burden among families at different income levels. Table 2 shows the Treasury Department's estimates of the distributional effects of the tax provisions in the Contract. The fourth column shows that of the $97.2 billion of annual tax cuts from the Contract provisions when fully phased in, $48.5 billion, or 50 percent, would benefit families with incomes over $100,000. These families would receive a disproportionately large share of the tax cuts, thereby reducing the progressivity of the Federal tax system. This reduction in progressivity can also be seen in the ratio of tax cuts to income (column six in the table), which increases with income throughout the income distribution.

Another dimension of fairness may be characterized as the "equal treatment of equals," or the imposition of similar tax burdens on taxpayers in similar circumstances. As discussed more fully below, several provisions in the Contract would create disparities in the tax burdens of similarly-situated taxpayers.

Simplicity is also a goal of tax policy by which the Contract should be evaluated. To the extent consistent with other tax policy goals, the income tax should be designed to minimize the cost of compliance by taxpayers and the administrative costs of the Internal Revenue Service (IRS). Several of the proposals may appear simple at first glance, but, as will be noted, a great deal of complexity must be introduced in order to implement these proposals and to reconcile them with the rest of the Tax Code. If this is not done, arbitrary and unfair distinctions are created, which also provide unintended opportunities for abuse.

Finally, the tax system should be efficient. We strongly believe the tax system should not encourage investment in uneconomic activities and a renewal of tax shelter activities. In the early 1980s, we experienced a proliferation of tax shelter activity, with very adverse results for investors, the tax system, and the economy. We should not repeat that experience by creating new opportunities for tax motivated transactions that distort economic and investment decisions.

1. $500 Per Child Refundable Tax Credit

Current Law

A tax exemption, in the form of a deduction, is allowed for each taxpayer and for each dependent of a taxpayer. A dependent includes a child of the taxpayer who is supported by the taxpayer and who has not attained the age of 19 at the close of the calendar year or who is a student under age 24. The deduction amount is $2,500 for tax year 1995. This amount is indexed annually for inflation.

In addition to an exemption for each child, three other tax benefits may accrue to taxpayers because of dependent children: the earned income tax credit (EITC), the credit for child and dependent care expenses, and the exclusion for employer-provided child and dependent care benefits. The EITC is a refundable tax credit based on the earnings of the taxpayer. The EITC is restricted to lower income taxpayers and phases out when earnings exceed specified levels. Although the EITC is available for taxpayers without dependents, the credit rate and income range of the credit are far greater when the taxpayer has one or more dependent children. In addition, the rate and income range are higher for taxpayers with two or more eligible dependent children than for taxpayers with only one eligible dependent child.

Proposal

The Contract with America would provide a $500 refundable tax credit for each child under age 18 for families with adjusted gross income (AGI) less than $200,000. The credit would be phased out for families with AGI between $200,000 and $250,000. The amount of the credit would be capped by the sum of the individual's income tax liability and any Social Security taxes paid with respect to the individual's earnings (including an employer's share of Social Security taxes). The $500 maximum amount would be indexed annually for inflation. The credit would be effective for tax years beginning in 1996.

The proposal would reduce tax receipts by $124.1 billion over the five-year FY1996 - FY2000 period, and by $288.5 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration supports the concept of a $500 per child tax credit, but believes the Contract proposal would be improved if targeted to middle-income taxpayers along the lines of the President's proposal.

The Contract proposal provides benefits for families with AGI up to $250,000. This income limitation denies the credit to only one percent of all otherwise eligible taxpayers.

2. American Dream Savings Accounts

Current Law

Taxpayers can contribute up to $2,000 to an individual retirement account (IRA). These contributions are deductible (so-called "front-loaded" IRAs), but the level of such deductible contributions is phased out for single filers with AGI between $25,000 and $35,000, and for joint filers with AGI between $40,000 and $50,000. If neither the taxpayer nor the taxpayer's spouse is an active participant in an employer-sponsored pension plan, then deductible contributions can be made, regardless of the taxpayer's income. No tax is imposed on the earnings on IRA balances. Taxpayers, however, are required to pay income tax on withdrawals. Penalty-free withdrawals from these front-loaded accounts are allowed only after the taxpayer reaches the age of 59 1/2, or upon disability or death of the taxpayer.

Proposal

The proposal would allow individuals, regardless of income and pension coverage, and, in some cases, regardless of employment status, to contribute up to $2,000 a year into an "American Dream Saving Account" (ADSA). ADSAs would be back-loaded, which means that contributions would not be tax deductible, earnings would not be taxed, and no tax would be imposed on withdrawals if certain conditions are satisfied. As with current-law IRAs, penalties would apply to premature distributions. Penalty-free withdrawals would be allowed after five years for the purchase of a first home, higher education expenses, or medical expenses including purchases of long-term care insurance. In addition, as with current-law IRAs, penalty-free withdrawals after five years would be allowed upon death or disability, or when the individual reaches the age of 59 1/2. Individuals could continue to contribute after age 70 1/2. The proposal would also allow individuals a one-time opportunity to convert their current IRA accounts into ADSAs. Income tax would be due on the total amount transferred, but the proposal would allow individuals to spread this tax liability, interest free, over four years. The proposal would be effective for tax years beginning in 1996.

Because of the addition of the one-time conversion feature, the proposal would increase tax receipts by $5.0 billion over the five-year FY1996 - FY2000 period, but would reduce receipts by $17.7 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration supports the expansion of IRAs, but believes the President's IRA proposal is more cost-effective than the ADSA proposal and provides taxpayers more with more choice in selecting a tax-favored savings incentive.

The nation's saving rate has declined dramatically since the 1970s. During that decade, net national saving averaged 7.2 percent of gross domestic product (GDP). Over the past ten years, the saving rate has averaged only 2.8 percent of GDP. The Administration is particularly concerned about the current level of national savings. We believe that the savings rate is too low to sustain a sufficient level of private investment into the next century. Without adequate investment, the continued healthy growth of the economy is at risk. A continuation of our successful policies of the past two years to reduce the Federal deficit is an essential element of any effort to improve the nation's savings rate. Increasing the personal savings rate is an essential supplement to that effort.

ADSAs are designed to provide an incentive to individuals to increase their savings. We support this goal. However, we do not believe that the Contract proposal as currently drafted is the best mechanism for reaching this goal.

ADSA contributions are not deductible, so they do not reduce current income tax liabilities. For many middle-income taxpayers, a major attraction of traditional IRAs is that contributions are deductible and, therefore, provide immediate tax relief. By requiring that contributions be made out of after-tax dollars, it is likely that ADSAs will be less attractive to many middle-income taxpayers than the deductible, front-loaded, IRAs. Conversely, ADS. will appeal primarily to more sophisticated savers, who have sufficient income and sufficient liquidity to make ADSA contributions out of after-tax dollars. Thus, the people whose contributions to tax-preferred saving accounts are most likely to represent new saving -- those with income of less than $100,000 -- are the ones more likely to contribute to front-loaded IRA accounts than to ADSAs. That is why the President's proposal (and other bipartisan IRA bills that have been introduced over the last few years) allow eligible taxpayers the option of choosing a traditional front-loaded IRA or a new back-loaded special IRA.

We also believe that broadening the tax incentives for saving for reasons other than retirement is an important element in any proposal to increase the nation's saving rate. By expanding incentives to include savings for first-time home purchases, higher education expenditures, and catastrophic medical expenses, ADSAs should prove to be more attractive to taxpayers than accounts limited to retirement savings. This should be particularly true for individuals with moderate incomes and those below the age of 35, who are now doing little saving. But these penalty-free withdrawal options should not be limited to ADSAs. They should be made available for IRAs, as proposed by the President and should also include penalty-free withdrawals for long-term unemployment and caring for an incapacitated parent.

In addition, the Contract proposal fails to target its benefits as well as the President's proposal to expand IRA benefits and does not provide a range of choices to taxpayers. It is thus less cost effective than the President's proposal in increasing net national saving. IRA contributions by wealthy taxpayers are much more likely to be financed by diverting assets from existing non-tax preferred accounts, while contributions by taxpayers with more moderate incomes are more likely to represent increases in savings. Thus, providing high-income taxpayers with the option of saving in tax-preferred accounts is unlikely to generate much in the way of new saving.

3. Favorable Tax Treatment of Long-Term Care Insurance and Services

Current Law

A taxpayer is allowed an itemized deduction for unreimbursed expenses that are paid by the taxpayer during any taxable year for medical care of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer to the extent that such expenses exceed 7.5 percent of the AGI of the taxpayer for such year. The cost of personal services, including custodial care, is a medical expense if there is a direct connection between the service and a recognized, specific medical condition, and the services are performed directly for the individual. Old age is not a sufficiently specific medical condition. Regulations provide that the entire amount of an expense may be treated as a medical expense if the expense is incurred primarily to provide medical care.

To the extent that long-term care is not classified as medical care, employer-provided care is taxable to the employee. Generally, benefits paid under a long-term care plan or policy are not treated as amounts received through accident and health insurance on an excluded basis unless the amounts received for long-term care represent reimbursement for medical care expenses.

Proposal

Long-term care services. The proposal would allow expenses for qualified long-term care services for the chronically ill to be deducted as an itemized medical expense (subject to the 7.5 percent of AGI limitation). Qualified long-term care services would include services required by a chronically ill individual in a qualified facility, including home care in certain circumstances, under care prescribed by a licensed health care practitioner. A chronically ill individual must require substantial assistance with at least two activities of daily living (ADLs) for a period of at least 90 days or have a similar level of disability due to cognitive impairment.

Long-term care insurance. The proposal provides that benefits could be received tax-free from a long-term care insurance policy. Benefits could be paid on a "per diem" basis without regard to the actual expenses incurred during the period to which the payments relate. However, whether paid on a reimbursement basis or a per diem basis, any benefits in excess of $200 per day (indexed for medical inflation care) for any single policy would be taxable. Individuals would be allowed to deduct premiums paid to purchase long-term care insurance as a medical expense (subject to the floor of 7.5 percent of AGI) to the extent the premiums do not exceed specified annual limits.

The value of employer-provided coverage under a long-term care insurance contract would not be included in an employee's income because the contract would be treated as accident or health insurance. An exchange of a life insurance, endowment, or annuity contract for a long-term care insurance contract would be treated as a tax-free exchange. In addition, the proposal would allow a tax-free distribution to an individual from an IRA or a 401(k) plan for the payment of premiums on a long-term care insurance contract for the benefit of the individual or the individual's spouse.

All provisions would be effective for taxable years beginning in 1996.

The proposal would reduce tax receipts by $5.9 billion over the five-year FY1996 - FY2000 period, and by $15.3 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration has developed similar proposals for the favorable tax treatment of long-term care insurance and services, and therefore supports the goals of the provisions included in the Contract. However, we believe a number of modifications are required to ensure that the proposals reflect sound tax policy.

In particular, we believe that the Contract's provisions that (i) allow tax-free withdrawals from IRAs and 401(k) plans to purchase long-term care insurance, (ii) allow tax-free exchanges of life insurance and annuity contracts for long-term care insurance contracts, and (iii) permit unlimited tax-free long-term benefits by allowing the purchase of multiple policies that provide a $200 per day benefit are too generous, and treat amounts paid for long-term care insurance much more favorably than out-of-pocket expenses. These provisions would allow individuals to purchase future long-term care insurance without being subjected to the funding and/or benefit restrictions imposed on a long-term care insurance policy.

4. Tax-Free Accelerated Death Benefits Under Life Insurance Contracts

Current Law

Payments made under a life insurance contract other than by reason of an insured's death are generally taxable. However, the tax treatment of payments made with respect to terminally ill insureds in anticipation of death is not entirely clear. Proposed regulations issued in 1992 would permit the tax-free receipt of accelerated death benefits in certain circumstances, and would allow accelerated death benefit riders to be added to current life insurance contracts without endangering such contracts from being disqualified as life insurance.

Distributions (other than policy loans) from a life insurance policy are taxable to the extent they represent income on the contract.

Proposal

The Contract would exclude from gross income certain distributions received by an individual under a life insurance contract if the insured under the contract is terminally ill. An individual would be considered terminally ill if a licensed physician certified that the individual's death was reasonably expected within 12 months of the certification.

The Contract would also permit tax-free payment of benefits from a life insurance policy on the life of an insured who is chronically ill and confined to a qualified long-term care facility (including home care).

The proposal would reduce tax receipts by $0.1 billion over the five-year FY1996 - FY2000 period, and by $0.4 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration generally supports this provision, although we believe it should be modified. For example, policyholder safeguards should be added to ensure that the payment of accelerated death benefits under a life insurance contract would not unduly lower the remaining value of the policy's death benefits or its cash value.

5. Increased Expensing Limit for Small Business

Current Law

The cost of business or income-producing property that provides service for more than one tax year generally must be deducted over the recovery period of the property. A taxpayer may elect, however, to deduct currently up to $17,500 of the cost of the property (i.e., "expense" the property). However, this $17,500 maximum is reduced for each dollar of the total cost of qualified property acquired during the year in excess of $200,000. Thus, if the cost of qualified property placed in service during the year exceeds $217,500, no expensing is allowed.

Proposal

The Contract with America would increase the maximum investment that may be expensed from $17,500 to $25,000 for tax years beginning in 1996.

The proposal would reduce tax receipts by $4.2 billion over the five-year FY1996 - FY2000 period, and by $5.0 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration supports an increase in the maximum investment that may be expensed for small businesses. The Omnibus Budget Reconciliation Act of 1993 (OBRA 93) increased the maximum from $10,000 to $17,500. We supported this Committee's version of OBRA 93 which, like the Contract, would have raised the maximum to $25,000. Increasing the maximum to $25,000 would provide an incentive for small businesses to increase their investment in capital assets. In addition, the proposal also would simplify tax reporting for eligible small businesses.

6. $5,000 Refundable Tax Credit for Adoption Expenses

Current Law

The Tax Reform Act of 1986 repealed a deduction of up to $1,500 for expenses related to special needs adoptions and replaced it with an outlay program with several components. States are required to reimburse families for costs associated with the process of adopting special needs children. The Federal government shares 50 percent of the first $2,000 of such costs. Some special needs adoptees are eligible for continuing Federal-State Social Security assistance, including Medicare, under Title IV-E of the Social Security Act. Other adoptees may be eligible for continuing assistance under state-only programs.

Proposal

The proposal provides a refundable tax credit of up to $5,000 for adoption expenses in tax years beginning in 1996 and subsequent years. The credit would be allowed for all adoptions, not solely for the adoption of a child with special needs. The credit would be phased out for taxpayers with AGI between $60,000 and $100,000.

The proposal would reduce tax receipts by $1.4 billion over the five-year FY1996 - FY2000 period, and by $3.3 billion over the ten-year FY1996 - FY2005 period.

Discussion

We believe that it is generally more cost-effective to target federal support for adoption to adoption of special needs children. By applying to all adoptions, this proposal provides benefits for adoptions that would occur even without the credit. In addition, administrative issues need to be addressed in the context of a refundable credit.

7. $500 Refundable Tax Credit For Elderly Care

Current Law

Current law allows taxpayers who support their parents or grandparents to claim a dependent exemption. In general, a taxpayer is entitled to an exemption of $2,500 in 1995 for each dependent. An elderly person may be claimed as a dependent of another taxpayer if the taxpayer provides more than one-half of the support of the elderly person and the elderly person has gross income below $2,500. In addition, single taxpayers can file as heads of households if they provide over one-half the costs of maintaining a home in which their dependent parents reside.

Current law also provides a nonrefundable tax credit for taxpayers 65 years of age or older who receive moderate amounts of social security, railroad retirement, and other pension annuity or disability benefits and who have modest amounts of income from other sources. The tax credit is an amount equal to 15 percent of an initial amount ($7,500 if a joint return is filed and both spouses qualify, or $5,000 if single or only one spouse qualifies), but reduced for certain nontaxable income and for AGI exceeding certain levels. Taxpayers may also be eligible for the child and dependent care tax credit or the exclusion for employer-provided child and dependent care benefits (see the "Current Law" description for item 1).

Proposal

Taxpayers would be eligible for a refundable tax credit if they maintain a household that includes an elderly and disabled parent or grandparent. The tax credit would be equal to $500 for each qualified person. A qualified person would include any parent or grandparent of the taxpayer whose principal place of abode is the taxpayer's home for more than one-half of the year and who is not able to perform at least two activities of daily living (e.g., bathing or dressing) or who suffers a similar level of disability due to cognitive impairment. The credit is available regardless of the taxpayer's income. The credit amount is not indexed. The provision would be effective for tax years beginning 1996.

The proposal would reduce tax receipts by $1.2 billion over the five-year FY1996 - FY2000 period, and by $2.6 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration is very concerned about the care of elderly and disabled individuals. We believe that the Administration's long-term care proposals made in 1993, as well as the President's IRA proposal, better address this issue and would provide many taxpayers with greater assistance than would the tax credit contained in the Contract. The President's proposals would also be easier to administer.

Under our long-term care proposals, taxpayers could deduct long-term care expenses if such expenses exceeded 7.5 percent of AGI. In addition, taxpayers could exclude employer contributions for long-term care insurance from their taxable income. Under the President's "Middle Class Bill of Rights" proposal, taxpayers would be allowed to withdraw funds, without penalty, from their IRAs in order to pay for nursing home and other long-term care expenses of their parents and grandparents.

8. Neutral Cost Recovery System

Current Law

For regular tax purposes, depreciation deductions for most tangible personal property are calculated using the 200-percent-declining-balance method over recovery periods of 3, 5, 7 and 10 years. Certain longer-lived types of property are depreciated using the 150-percent-declining-balance method over recovery periods of 15 and 20 years. The straight-line method is used over periods of 27.5 and 39 years for residential and nonresidential real property, respectively. Certain other specified property (including property used by a tax-exempt entity, property used predominantly outside the United States, and property financed with tax-exempt bonds) is depreciated using the straight-line method over a prescribed recovery period. Depreciation deductions are not indexed for inflation.

For purposes of the alternative minimum tax (AMT), property other than residential or nonresidential real property is depreciated using the 150-percent-declining-balance method over assigned class lives. These class lives are generally longer than regular tax recovery periods. Real property is depreciated for AMT purposes using the straight-line method over a 40-year recovery period.

Proposal

The proposed "neutral" cost recovery system (CRS) would replace the current depreciation system for property placed in service after December 31, 1994. Taxpayers would compute cost recovery allowances using the 150-percent-declining-balance method for tangible personal property, and the straight-line method for real property, over the recovery periods prescribed under current law. These recovery allowances would be adjusted upward by multiplying them by "CRS ratios". For assets with recovery periods of 10 years or less (most tangible personal property), the CRS ratios would adjust for actual inflation (based on the GDP deflator) plus 3.5 percent per year for each year the property has been in service; for all other depreciable assets (including real property), the CRS ratios adjust only for inflation. Additional depreciation adjustments attributable to the CRS ratio would not reduce the basis of assets or any interest in a pass-through entity holding these assets, and would not affect recapture. The CRS ratios could not be less than one, and the sum of the adjusted cost recovery allowances would exceed the original basis of the property if the property were held for its full recovery period.

Depreciation deductions under the AMT system for CRS property would be calculated in the same fashion. Allowances would be computed as under the AMT system prescribed by current law, but would be adjusted upward for actual inflation, plus 3.5 percent for property with recovery periods of 10 years or less.

Because of the slower depreciation method for some property, the proposal would increase tax receipts by $18.4 billion over the six-year FY1995 - FY2000 period. However, tax receipts would be reduced by $120.4 billion over the eleven-year FY1995 - FY2005 period.

Discussion

The Administration opposes this cost recovery system because it would encourage uneconomic investment and tax shelter activity and would be very costly beyond the five-year budget window. The CRS proposal would also add significant complexity to the tax system.

Table 3 provides an example of how CRS back-loads revenue losses. It compares depreciation deductions for a property acquisition under current law and under CRS, assuming a seven-year recovery period and 3.0 percent annual inflation. While deductions are smaller for the first three years, total deductions increase by over 23 percent. The early revenue gains accrue entirely from property with recovery periods of ten years or less. For longer-lived property, CRS loses money after the first year.

For equipment, CRS is intended to provide taxpayers with deductions spread over a period of years that have the same present value as expensing, thus reducing the effective tax rate on the income for new investment to zero (as under a consumption-based tax). In a consumption-based system, however, the return on all investments, and not solely investments in equipment, would be subject to an effective tax rate of zero. The proposal does not achieve tax neutrality with respect to investment decisions.

Contrary to its title, this cost recovery system is clearly not "neutral." The difference in treatment between short-lived tangible property and real and other property (including certain intangibles), the difference in treatment of assets subject to CRS and assets subject to the capital gains indexation provisions, and the ability of a taxpayer to elect out of CRS on a property-by-property basis, all compel taxpayers to consider carefully the tax impact on the investment decision. Furthermore, the CRS proposal creates a bias against investment in longer-lived depreciable property, in non-depreciable property, and in certain intangible property.

The CRS subsidy is so large, especially when coupled with the Contract's capital gain proposal, that it could lead to significant investment in uneconomic activities. Taxpayers will have significant incentives to engage in transactions designed to use CRS deductions to shelter other income from tax. Some businesses will even be able to "zero-out" their tax liabilities (including their AMT liabilities). The net effect may well be to hurt, rather than help, the economy, just as very accelerated depreciation allowances in the early 1980s contributed to the proliferation of "see-through" buildings.

The policy justifications for these differences are far from clear. In fact, the exclusion of real property from application of the full CRS adjustment may serve to aggravate the existing controversy regarding classification of components of real property. In addition, property subject to CRS is precluded from application of the capital gains indexation provisions.

The CRS introduces substantial additional complexity to an already complex depreciation system. Depreciable property placed in service after December 31, 1994 will be subject either to CRS with the full CRS ratio, to CRS with an inflation adjustment only, or to the current cost recovery system (i.e., for property not eligible for CRS or property that the taxpayer elects to have excluded, which may be the case if the taxpayer intends to index for purposes of capital gains). Moreover, property subject to CRS will have to be tracked by quarter and year of acquisition. In addition, existing property will continue to be subject to current depreciation provisions, including the AMT system.

In addition to these areas of complexity, there are a number of areas where the interaction of the CRS provisions with related provisions of the Code is not addressed in the statutory language. Issues such as the effect of additional CRS deductions on the normalization rules, the operation of the CRS provisions with certain pass-through entity provisions (e.g., election to adjust basis of partnership property), and the interaction of CRS provisions with general asset accounts must be addressed. In addition, specific, detailed anti-churning rules would be required to assure that only new property is being covered in the CRS.

9. Capital Gains Tax Preferences

Current Law

Under current law, nominal capital gains are fully included in taxable income upon realization, and for taxpayers in the 15 percent and 28 percent brackets are taxed at ordinary rates. In general, individual taxpayers in the 31, 36, and 39.6 percent tax brackets pay a maximum capital gains rate of 28 percent. The 28 percent maximum rate effectively provides exclusions of 10, 22, and 29 percent to taxpayers in the 31, 36, and 39.6 percent tax brackets, respectively. Capital losses can be deducted against capital gains, and up to $3,000 of net capital losses per year can be deducted against other income.

Capital gains on the sale of a principal residence can be deferred if the taxpayer purchases a replacement residence of equal or greater value. Taxpayers age 55 and over are eligible for a one-time exclusion of up to $125,000. Capital losses on principal residences are not deductible.

OBRA 93 provided a 50 percent exclusion for gains on the sale of certain small business stock that is purchased directly from the business (or through an underwriter) at the time of issue and held for at least five years. Eligible corporations must have assets (including the funds from the stock issue) of under $50 million and must meet certain other conditions throughout the taxpayer's holding period. The amount of gain eligible for the 50 percent exclusion is limited to the greater of ten times the taxpayer's basis in the stock and $10 million gain from the stock in that corporation. One half of the excluded gains are treated as a preference for purposes of the Alternative Minimum Tax.

Proposal

The proposal would allow individuals and corporations to deduct 50 percent of net long-term capital gains from gross income effective January 1, 1995. Only 50 percent of net long-term losses would be deductible. These capital losses could offset ordinary income up to the annual $3,000 limitation. The 28 percent maximum tax rate on taxable gains of individuals and the targeted small business capital gains provision in OBRA 93 would be repealed. In addition, individuals and corporations could prospectively index the basis of corporate stock and certain tangible assets (including collectibles such as antiques) for inflation after January 1, 1995 in computing gains and losses. The proposal also would allow individuals to deduct any capital loss from the sale or exchange of a principal residence, subject to the annual $3,000 limitation on the deduction of net capital losses.

The proposal would reduce tax receipts by $60.9 billion over the six-year FY1995 - FY2000 period, and by $183.1 billion over the FY1995 - FY2005 period.

Discussion

The Administration opposes the 50 percent exclusion and indexing proposals. The combination of these proposals is too generous, too complex, and not well targeted, both with respect to the investors benefitted and the assets included. The OBRA 93 capital gains exclusion (which would be repealed by the Contract) is limited to new investments, and thus does not provide a windfall benefit to existing investments. It is also limited to small businesses, thus reducing the cost of equity capital to those businesses that are most likely to find it difficult or costly to obtain financing. We believe that additional incentives for new investment, if they are determined to be necessary, should likewise be targeted and consistent with the tax policy principles of fairness, efficiency, and simplicity.

50 Percent Exclusion. Proponents of a 50 percent capital gains exclusion argue that this exclusion could reduce barriers to the sale of existing assets by taxpayers with unrealized gains. But it would also increase the incentive to convert ordinary income to capital gains and confer the largest benefits to the highest-income taxpayers. Consequently, the Administration believes that the exclusion is too large and is not sufficiently cost effective.

Studies of the effects of capital gains tax cuts by the Treasury (1985), the Congressional Budget Office (1990), and the Congressional Research Service (1990) have all concluded that any effects on saving, investment and economic growth are likely to be quite small. This is because much of the income from savings is already tax favored, the responsiveness of saving to changes in the after-tax return is uncertain, and only a fraction of the additional savings will be used to fund new investment in domestic plant and equipment.

Increasing the preferential treatment of capital gains would create economic efficiency losses and make the tax system more complex by encouraging taxpayers to convert ordinary income into capital gains. One example of such tax arbitrage is contributing ordinary income property to a corporation and then selling the stock of the corporation. Corporations used in this way are referred to as "collapsible" corporations. The Code contains provisions aimed at preventing abuse through the use of collapsible corporations, but these and other provisions designed to prevent similar abuses are extremely complex. Such complexity increases transaction costs to taxpayers and the costs of ensuring compliance for the IRS. While incentives to engage in tax arbitrage, and thus some of the accompanying complexity, already exist as a result of current law's limited preferences for capital gains, this proposal would greatly increase taxpayers' incentives to engage in arbitrage transactions.

Indexing. Proponents of indexing of capital assets contend that it limits capital gains taxes to "real" gains that increase a taxpayer's purchasing power as opposed to "nominal" gains that result simply from inflation and do not increase the taxpayer's purchasing power. The best approach to deal with inflation, however, is to keep the rate of inflation low. The combination of the deficit reduction under this Administration and Federal Reserve policies has achieved this goal -- inflation over the past year has been held to under 3 percent.

Even if some form of capital gains relief is considered desirable, providing <u>both</u> an exclusion and indexation of basis clearly provides too large an adjustment for inflation. Rather than taxing "real" gains, the combination of indexing and the 50 percent exclusion would largely eliminate the capital gains tax. For example, for a taxpayer in the 28 percent bracket who sells after one year a $1,000 capital asset that increased in value by 8 percent while prices generally increased by 3 percent during the year, the capital gains tax would decrease by 69 percent (from $22.40 to $7.00), resulting in an effective tax rate on the nominal gain of 8.75 percent.

Indexing the basis of capital assets for inflation would significantly increase complexity and distortions in the tax system. This is one of the reasons this proposal has been rejected, after careful consideration, in the past. Basis indexation has the potential to affect every area of the Code. Addressing all of these aspects would add considerable complexity to the Code, while ignoring them would leave the door open to tax avoidance opportunities. Indexing basis would also place a great deal of strain on the Internal Revenue Service's ability to administer the tax system.

The distinction between real and nominal gains is not limited to the assets that would be indexed under the proposal. For example, interest payments on debt have inflationary components, as do capital gains. Yet the Contract would not differentiate between real and nominal interest income or deductions. Indexing the basis of capital assets without indexing debt used to finance these assets would greatly expand the potential for tax arbitrage and tax shelter opportunities. Without complicated anti-arbitrage provisions, indexing capital gains alone would make it possible for taxpayers to reduce their effective tax rates to zero.

For example, assume that a taxpayer purchases undeveloped land for $100,000, giving a $20,000 cash down payment and borrowing $80,000. If the land were sold several years later for $130,000, with the $30,000 gain representing an inflationary increase in the value of the property the taxpayer could repay the $80,000 mortgage and retain $50,000 in cash without being subject to taxation. However, only $6,000 (20,000/100,000 x $30,000) of the taxpayer's total $30,000 gain from the transaction represents the inflationary gain on the taxpayer's $20,000 investment; the remaining $24,000 of gain has been shielded from taxation because the proposal would index the basis in the property but not the debt or the interest adjustments used to finance it.[4]

Unlike some previous indexing proposals considered by Congress, this proposal would allow nominal capital gains to be turned into deductible capital losses. Under current law, taxpayers already benefit from the fact that their capital gains are taxed only when realized. They are thereby encouraged to claim losses when the losses are incurred, while deferring the tax on gains. This proposal would even allow taxpayers with gains that have not kept pace with inflation to claim losses on those nominal gains. Also, the use of quarterly indicators to measure inflation could lead to a disruption of the normal operation of markets as investors attempt to recognize their gains early in any given calendar quarter.

Rules would have to be developed to address the treatment of common investments made by many individuals, such as dividend reinvestment plans in mutual funds and investments in partnerships and other pass-through entities. Computation of the taxpayer's income in each of these cases would require more than merely determining basis, holding period, and the amount realized. Rather, these circumstances would require the development of special indexing rules that coordinate entity level and investor level adjustments and provide appropriate allocation of indexation benefits among investors. Rules would also have to be developed for complex transactions involving indexed assets where the date of sale or acquisition may be unclear, such as sales pursuant to forward contracts, options, and sales with contingent purchase prices. Similar issues arise with respect to a disposition pursuant to a corporate or partnership distribution, or an installment sale. Adjusting the basis of investments in foreign tangible property and certain foreign stocks for domestic inflation

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[4] Stated differently, because of indexation of gains, the taxable gain on the asset is reduced from $30,000 to zero, but because of the failure to index liabilities, taxpayers escape tax on the $24,000 real gain on the debt.

would generate additional complexities, especially under the tax rules that apply to foreign currency. Complexity would also result from adjustments made to basis over time as the result, for example, of improvements to real property or contributions to the capital of a corporation.

Any system of indexation would have to provide rules for all these cases. Every such rule, however, would impose additional computational burdens of a magnitude far greater than the single basis calculation now required. While certain simplifying assumptions could be adopted, these simplifications would arbitrarily deny indexation benefits to some taxpayers while providing planning opportunities to others.

Deduction of Losses on Principal Residences. We have some concerns about the proposal to allow the deduction of losses on sales of principal residences. Generally, the tax law does not allow capital losses arising from personal use assets. Under the proposal, taxpayers in neighborhoods or sections of the country that experience general declines in real estate prices would benefit, but the proposal would also benefit those whose homes have lost value from anticipated real depreciation or other deterioration in the property.

10. Phase Out of the 85 Percent Maximum Inclusion Rate for Social Security Benefits

Current Law

The amount of Social Security benefits included in income is determined by the amount of income and benefits in excess of certain thresholds. The thresholds also determine the maximum percentage of benefits included in AGI.

Under OBRA 93, people with income and Social Security benefits above the top threshold must include up to 85 percent of Social Security Benefits in AGI, beginning in 1994. The top threshold is $34,000 for unmarried individuals and $44,000 for married individuals. The amount of benefits subject to tax is: (1) 85 percent of income and benefits over the threshold, plus (2) an adjustment for amounts below the threshold subject to inclusion at the 50 percent rate. However, the total taxable amount does not exceed 85 percent of benefits. The OBRA 93 change does not apply to people with income and benefits below the top threshold. The revenue from the OBRA 93 changes is earmarked for the Hospital Insurance (HI) trust fund.

Proposal

The Contract with America would phase out the OBRA 93 changes in the taxation of Social Security (and Railroad Retirement Tier I) benefits. As a result, not more than 50 percent of Social Security benefits would be subject to income tax, regardless of the level of the beneficiary's total income. The phase out would occur between 1995 and 2000. This change would affect only taxpayers with income above the second threshold ($34,000 for single taxpayers and $44,000 for married taxpayers filing jointly).

The proposal would reduce tax receipts deposited in the Hospital Insurance (HI) Trust Fund by $15.0 billion over the five-year FY1996 - FY2000 period, and by $48.5 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration opposes this proposal, because the OBRA 93 changes were necessary to achieve consistent tax treatment of retirement income, and because it would reduce revenues needed for the HI Trust Fund.

Even with the changes in OBRA 93, Social Security benefits generally receive more favorable tax treatment than do pension and other retirement income. Generally, the portion of pension payments representing previously untaxed income is included in gross income when received, while the portion of pension payments representing previously taxed contributions is excluded. Social Security benefits are treated more favorably. For those with higher incomes, the portion of Social Security benefits subject to tax is phased in, based on the recipient's total income level. However, even for the highest income retirees, no more than 85 percent of benefits are taxed, even though over 90 percent of the benefits may represent previously untaxed income.

The OBRA 93 increase affected only 13 percent of taxpayers reporting Social Security benefits in 1994 -- those at the high end of the income distribution of beneficiaries. The OBRA 93 changes did not affect the other 87 percent of taxpayers receiving benefits.

11. Tax Credit to Reduce Marriage Penalties

Current Law

Couples in which both spouses have similar levels of income generally have a higher tax liability than the combined tax liability of two single persons with the same levels of income. This extra amount of tax is called a "marriage penalty." Conversely, where one spouse has most or all of the couple's income, the tax liability of the couple is usually lower than the combined liability of two single persons with the same levels of income. This lesser tax liability is called a "marriage bonus." The extent of the marriage penalty or bonus depends on the division of income, deductions, and credits between the spouses as well as on the relative sizes of standard deductions, on the level of income tax rates, and on the relative widths of income tax brackets for married and unmarried taxpayers.

If couples filed tax returns as two separate individuals, there would be neither marriage penalties nor bonuses (except for those living in community property states). But married couples with the same total income would then pay different amounts of tax, depending on the division of income between them.

Proposal

The proposal provides a tax credit in the amount of, but not more than, a married couple's "marriage penalty." The dollar amount of the credit would be determined each year by the Secretary of the Treasury so that the aggregate amount of credits for all taxpayers would not exceed $2 billion for the year. The proposal would be effective for tax years beginning after the date of enactment.

The proposal would reduce tax receipts by $9.0 billion over the five-year FY1996 - FY2000 period, and by $19.0 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration does not support this particular proposal because it lacks detail on the allocation of benefits and would be difficult to administer. We would, however, be willing to work with the Committee to consider other ways to address this issue.

Since the total amount of marriage penalties greatly exceeds the $2 billion a year limit on the cost, this proposal would only partially reduce, but not fully eliminate, marriage penalties. As a result, one major problem with the proposal is the lack of detail on how the $2 billion of benefits would be allocated among families with marriage penalties. Another problem is that marriage penalties intrinsically depend upon how people would live if they were not married -- what housing arrangements they would make, how they would divide their assets, etc. While a hypothetical calculation can be made, such a calculation may overstate the actual penalty for some and understate it for others.

The proposal could also result in a married two-earner couple having a lower tax liability than a one-earner couple with the same total income and deductions. Moreover, the proposal does not address the treatment of heads of household. Any proposal that significantly reduced marriage penalties while leaving marriage bonuses unchanged would shift the overall tax burden away from families filing joint returns and would increase the relative tax burden of heads of household and single persons.[5]

12. Expansion of the Home Office Deduction

Current Law

Under current law, home office expenses are deductible only if the home office is used (1) as the principal place of business, (2) as a place of business used by patients, clients

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[5] As the result of complaints about tax penalties for single persons, in 1969 a separate tax rate schedule was enacted for single taxpayers. Prior to that time, single taxpayers used the same tax rate schedules as married taxpayers filing separate returns.

or customers in meeting or dealing with the taxpayer in the normal course of business, or (3) in the case of a separate structure which is not attached to the dwelling unit, in connection with the taxpayer's trade or business.

The principal place of business definition was interpreted by a recent Supreme Court case. In *Commissioner v. Soliman*, 113 S. Ct 701 (1993) the Supreme Court held that the principal place of business should be defined to include only the place of business where the activities most crucial to the operation of the business occur. As a result of the decision, the Internal Revenue Service set forth in Revenue Ruling 94-24 the factors to be applied in determining whether a taxpayer's home office qualifies as a principal place of business. For example, activities crucial to certain service businesses require personal contact with customers outside the service provider's home office. In such cases, the home office would not be regarded as the principal place of business, even if no other principal place of business existed.

Proposal

The Contract with America proposal would loosen the standards under which home office deductions would be allowed. The proposal would allow deductions for an office where a taxpayer's essential administrative or management activities are conducted on a regular basis provided the taxpayer has no other place to perform those activities. The proposal would also allow a taxpayer to deduct costs attributable to the storage of product samples in a residence if the taxpayer is engaged in the business of selling those products at retail or wholesale and the residence is the sole fixed location of the taxpayer's business.

The proposal would reduce tax receipts by $0.4 billion over the five-year FY1996 - FY2000 period, and by $1.0 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration believes this proposal needs further review in order to minimize potentials for abuse and associated audit difficulties.

13. Increase of the Estate Tax Exemption to $750,000

Current Law

Under current law, an exemption from estate tax is generally allowed for the first $600,000 of a taxable estate. This is effected through a credit of $192,800 against estate tax, which translates into an exemption for $600,000. The credit reduces the estate tax liability of most decedents, but is phased out for estates that exceed $10 million. The credit is referred to as the "unified credit" because it is also utilized (and reduced to the extent so used) to offset gift tax.

Proposal

The proposal contained in the Contract with America would increase the amount of the unified credit against estate tax. The increase would be to $700,000 for decedents dying (and gifts made) in 1996, $725,000 in 1997, $750,000 for 1998, and would be indexed for later years.

The proposal would reduce tax receipts by $6.7 billion over the five-year FY1996 - FY2000 period, and by $20.7 billion over the ten-year FY1996 - FY2005 period.

Discussion

The Administration recognizes that this threshold has not been increased since 1987. We are willing to work with the Committee to address this issue. However, we are concerned about the cost of this proposal and the limited number of taxpayers it would affect. Only one percent of all estates are taxable with the current exemption, and only half of one percent would be taxable under the proposed increase in the exemption.

14. Income Tax Return Check-off for Deficit Reduction

Current Law

The Presidential Election Campaign Fund check-off is the only analogous federal program. Section 9006 of the Internal Revenue Code establishes the Presidential Election Campaign Fund (the Campaign Fund). Each taxpayer may designate, by checking the appropriate box on his or her income tax return, that $3 be paid into the Campaign Fund. The amount designated for the Campaign Fund does not affect the taxpayer's tax liability. Monies in the Campaign Fund are used for three purposes: (1) payments to the national committee of each major and minor political party for its nominating convention; (2) payments to the eligible candidates of a political party for President and Vice-President; and (3) payments to eligible candidates seeking the nomination of a political party to be President.

Proposal

The Contract would allow individual taxpayers to designate on their federal income tax returns up to ten percent of their tax liability to be earmarked for reducing the public debt. The IRS would tabulate the amounts designated and the Treasury Department would transfer those amounts into a "Public Debt Reduction Trust Fund" (the Trust Fund). The amounts in the Trust Fund would be used to retire or purchase outstanding Treasury securities, and therefore could not be used to fund federal programs.

The proposal also mandates a corresponding decrease in federal spending through an essentially across-the-board sequestration. Social security payments, net interest payments on federal debt, and funding for certain insurance funds established to resolve the savings and loan problem are exempted from sequestration under the bill.

Sequestration reports under the Balanced Budget and Emergency Deficit Control Act of 1985 would be expanded to include an estimate of the amount earmarked to the Trust Fund. Budget authority for the new fiscal year would be cut by the "sequestration percentage" (i.e., the total amount earmarked by taxpayers for debt reduction divided by all government spending programs that are not explicitly exempted).

The provisions of this proposal would remain in effect until the entire outstanding public debt is retired.

Discussion

This Administration has a strong commitment to deficit reduction and supports the goal of this proposal, which is to impose discipline on spending by the federal government and, in doing so, reduce the amount of outstanding Federal debt. The Administration opposes the proposal, however, because of the potentially adverse effects it could have on the legislative process, the budget process, and the economy. In addition, the proposal would complicate tax returns and tax administration.

By requiring across-the-board spending cuts, the proposal could disrupt the orderly development of a Federal budget and discourage the Administration and Congress from making difficult budgetary choices. The proposal would allow certain individuals effectively to override Congressional choices by extending to those designating a transfer to the Trust Fund the right permanently to reduce the level of federal spending. Further, by incorporating a "one dollar, one vote" concept into the budgetary process, the fundamental "one person, one vote" tenet of our political system would be undermined. The proposal would allow citizens with significant tax liabilities to have a potentially greater voice in the way Federal funds are spent than those who incur little or no tax liability. The millions of voters who have no income tax liability would, in a sense, be disenfranchised, even though these individuals pay payroll and excise taxes. The role of government in society, and the way in which Federal monies are raised and spent, clearly are questions that deserve to be addressed by all citizens. These fundamental issues should be decided through the voting process, not through the tax system.

Amounts designated to the Trust Fund reduce Congressional budget authority for the following fiscal year, and in all future years. Thus, designations in successive years would result in significant cumulative reductions. These spending cuts, which are required to be spread equally across nearly all federal programs, would quickly have major, and in many instances unanticipated, impacts on these programs.

15. Regulatory Reform

The Administration supports the goal of reducing regulatory burdens to the extent compatible with responsible administration of the laws. Nevertheless, this Administration and the prior two Administrations have recognized that a "one-size-fits-all" approach to regulations is not in the best interests of the public or the government.

The IRS already must satisfy elaborate procedures before issuing regulations and taxpayers have extensive safeguards in enforcement proceedings. If existing procedures and safeguards need amendment, we would welcome the opportunity to work with this Committee to achieve a satisfactory result.

We assume that many of the Contract's regulatory and enforcement reform provisions were not intended to apply in the tax area. Nevertheless, the Contract would apply as written, and it is important to consider the consequences.

Proposal

The Contract would establish many additional requirements for issuing tax regulations. For example, a 23-point regulatory impact analysis would have to be prepared for each regulation. This analysis would include an evaluation of the costs and benefits to be derived from the regulation, a demonstration that the regulation adopted the least costly approach, and a description of the alternative approaches that were considered but rejected. In addition, no regulation could be issued unless the Office of Management and Budget (OMB) certified, among other things, that the regulation was easily readable, employed proper grammar, used short and well-organized sentences, and did not contain double negatives, confusing cross-references, or words with multiple meanings.

Other provisions would grant those subjected to Federal investigative, enforcement or official proceedings more rights.

Discussion

The Internal Revenue Code is extraordinarily complex and there inevitably are questions as to the meaning of its provisions and the ways in which they interact with each other. Without regulatory guidance interpreting the Code, taxpayers would be subject to uneven enforcement of the tax laws, denied the certainty they need to plan for the long term, and hesitant to engage in productive economic activities.

For these reasons, the Treasury is often requested to issue more tax guidance, more promptly. The prior Administration also has recognized the critical role of tax regulations and, therefore, did not apply the 1992 regulatory moratorium to those regulations.

By putting tax regulations "on hold" until the completion of a complex regulatory impact analysis and other requirements, the Contract would bog down the guidance process and increase compliance burdens on taxpayers. The Contract also would undermine the ability of taxpayers to rely on published guidance by permitting any tax protestor to challenge the validity of a regulation on procedural grounds. Congress has long recognized in the Anti-Injunction Act and Declaratory Judgment Act that the tax collection system could not function if taxpayers could so easily disrupt IRS operations.

These issues should be in the jurisdiction of the tax writing committees. We would like to work with the Committee to insure that the tax regulatory process continues to function in an orderly and efficient manner.

Conclusion

The Administration has serious reservations about some of the provisions in the Contract, but it also shares goals that would be advanced by other provisions in the Contract. The Administration is interested in crafting a set of tax cut proposals that are affordable, simple, efficient, and focused on middle-income families. We look forward to working with this Committee to develop proposals that meet these criteria and are acceptable to the Congress, the President, and the American people.

Table 1

Preliminary Estimates */

CONTRACT WITH AMERICA

Proposal 01/10/95 09:41 AM	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	1995-00	1995-2005
	Fiscal years ($ billions)												
1 $500 per child tax credit	--	-13.4	-27.0	-27.2	-27.4	-28.9	-30.4	-31.9	-33.4	-33.6	-35.1	-124.1	-288.5
2 American Dream Savings Accounts	--	0.3	1.3	1.9	1.3	0.2	-1.7	-3.6	-4.7	-5.9	-6.8	5.0	-17.7
3 Favorable tax treatment of long-term care insurance and services	--	-0.9	-1.1	-1.2	-1.3	-1.4	-1.6	-1.7	-1.9	-2.0	-2.2	-5.9	-15.3
4 Tax-free accelerated death benefits under life insurance contracts	--	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4
5 Increased expensing limit for small business	--	-0.8	-1.3	-0.9	-0.7	-0.4	-0.3	-0.2	-0.1	-0.1	-0.0	-4.2	-6.0
6 $5,000 refundable tax credit for adoption expenses	--	-0.0	-0.3	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-1.4	-3.3
7 $500 refundable tax credit for elderly care	--	-0.1	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-1.2	-2.6
8 Neutral cost recovery	3.3	10.0	13.4	8.5	-2.6	-14.1	-21.5	-26.0	-28.7	-30.4	-32.2	18.4	-120.4
9 Capital gains tax preferences	0.2	-1.1	-8.4	-15.0	-17.4	-19.2	-20.9	-22.6	-24.4	-26.2	-28.2	-60.9	-183.1
10 Phase-out of the 85 percent maximum inclusion rate for social security benefits	--	-0.5	-1.9	-3.2	-4.2	-5.2	-5.9	-6.3	-6.7	-7.0	-7.4	-15.0	-46.6
11 Tax credit to reduce marriage penalties	--	-1.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-9.0	-19.0
12 Expansion of the home office deduction	--	-0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-1.0
13 Increase of the estate tax exemption to $750,000	--	0.0	-1.4	-1.6	-1.8	-2.0	-2.2	-2.5	-2.8	-3.1	-3.5	-6.7	-20.7
	3.5	-7.6	-29.0	-41.5	-57.0	-73.9	-87.5	-97.7	-105.5	-111.2	-118.3	-205.4	-725.5

Department of the Treasury
Office of Tax Analysis

*/ Estimates are preliminary. The Office of Tax Analysis has had only a short time to analyze the legislation in its current form. There have been significant changes in some of the provisions since the original legislation was released on September 27, 1994.

PRELIMINARY

Table 2
Tax Proposals in "Contract with America" (1)
(1994 Income Levels)

Family Economic Income Class (4) (000)	Federal Taxes Under Current Law (2)			Change in Federal Taxes (3)			Total Federal Taxes After Change		
	Amount ($B)	As a Percent of Pre-Tax Income (%)	As a Percent of After-Tax Income (%)	Amount ($B)	As a Percent of Pre-Tax Income (%)	As a Percent of After-Tax Income (%)	Amount ($B)	As a Percent of Pre-Tax Income (%)	As a Percent of After-Tax Income (%)
0 – 10	6.4	7.5	8.1	-0.4	-0.5	-0.5	6.1	7.1	7.6
10 – 20	25.8	9.4	10.3	-1.8	-0.7	-0.7	24.0	8.7	9.6
20 – 30	54.7	13.8	16.0	-4.3	-1.1	-1.2	50.5	12.7	14.7
30 – 50	152.3	17.3	20.9	-12.4	-1.4	-1.7	139.9	15.9	19.2
50 – 75	204.1	19.1	23.6	-15.3	-1.4	-1.8	188.8	17.7	21.8
75 – 100	175.2	20.5	25.8	-14.2	-1.7	-2.1	161.0	18.8	23.7
100 – 200	244.5	21.3	27.1	-21.0	-1.8	-2.3	223.5	19.5	24.8
200 & over	275.0	23.3	30.3	-27.5	-2.3	-3.0	247.6	20.9	27.3
Total (5)	1,139.8	19.5	24.2	-97.2	-1.7	-2.1	1,042.5	17.8	22.1

Department of the Treasury
Office of Tax Analysis

January 10, 1995

(1) This table distributes the estimated change in tax burdens due to the tax provisions in the "Contract with America," as introduced January 4, 1995 in H.R. 6, H.R. 8, H.R. 9, and H.R. 11. The effect of the proposed change in the estate tax exemption is excluded.

(2) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total comsumption expenditures. Taxes due to provisions that expire prior to the end of the Budget period are excluded.

(3) The change in Federal taxes is estimated at 1994 income levels but assuming fully phased in law and long-run behavior. The effect of the back-loaded ADSA proposal is measured as the present value of tax savings on one year's contributions. The effect of the neutral cost recovery proposal is measured as the present value of the tax savings from one year's investment. The effect of the prospective capital gains indexing proposal is the fully phased in tax savings, multiplied by the ratio of the sum of the present values of prospective indexing over 20 years to the sum of the present values of fully phased in indexing over 20 years, holding realizations constant. The effect on tax burdens of the proposed capital gains exclusion and prospective indexing are based on the level of capital gains realizations under current law. The incidence assumptions for tax changes is the same as for current law taxes (see footnote 2).

(4) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family, rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(5) Families with negative incomes are included in the total line but not shown separately.

TABLE 3

Comparison of Deductions Under Current Law and the "Neutral" Cost Recovery System (CRS)

(Example of a $1,000 asset with a 7 year recovery period and 3% inflation)

Year	Current Law	CRS	Difference
0	143	107	-36
1	245	204	-41
2	175	171	- 4
3	125	148	23
4	89	158	69
5	89	169	80
6	89	180	91
7	45	96	51
Sum	1,000	1,233	233

Chairman ARCHER. Thank you, Mr. Samuels.

There are several questions that come to mind, and that probably will not surprise you.

I have noted over the years that, even during the Reagan administration, that the Treasury has opposed the indexing and the cost basis for capital gains. So, your presentation today is no different than it has been for many, many years. Yet this committee has passed on several occasions, with overwhelmingly bipartisan basis, the indexing, recognizing that it is totally unfair to tax inflation.

I must say that although your testimony is no surprise to me, I believe this committee will once again override the position of Treasury and do what is right for the people of this country.

As far as the complexity for the taxpayer is concerned, the details that you mentioned, I understand the law and I am very sensitive to it. As you know, I do my own income taxes, so I suffer through all of the complexities, like all the detailed records required of taxpayers as to every cost that they put into an asset, even if they hold it for 50 years under the current capital gains tax requirements. I do not see it will be a whole lot more complicated to simply take a table from the Treasury and add on *x* amount based on the inflation that has occurred over the years that the asset has been held.

If I make an improvement to my house, I have to keep a permanent record of that in great detail under the current law. I do not see that that would really be changed. So maybe I misunderstood your testimony relative to the details that would be imposed as a result of indexing on the taxpayer.

Mr. SAMUELS. Mr. Chairman, it is correct that taxpayers are required to keep records on improvements and the times of purchase and the price. It is our view that when you take a look at the details, and it is important to get into the details of this, that adding the burden on to taxpayers of keeping track of cost-of-living adjustments, inflation adjustments, over a long period of time, will add a significant burden to them.

Take, for example, mutual funds. You own a mutual fund and you reinvest your dividends, which many people do. It is very common for a mutual fund shareholder to reinvest dividends. Well, if you reinvest your dividends—let us assume they redistribute dividends quarterly, or sometimes even monthly. You have to keep track of all of that and then apply these factors to each month. And, in our view, that will add considerable burden on to taxpayers.

I think the other issue, on indexing, is that the indexing proposal is limited. It does not apply to all assets, and it does not apply to liabilities, and that is the reason that we believe that it will give rise to significant tax shelter opportunities.

Chairman ARCHER. Well, when the indexing proposal was designed by the Joint Committee, and when Mr. Wexler did most of the work on it, as a member of the staff of the Joint Committee, all of that was considered, and the Joint Committee designed this and approved it as the appropriate approach. So I guess, here again, the Treasury is in disagreement with the Joint Committee.

I do not want to pursue that laboriously. It is interesting for me to note that as I look at your presentation that the so-called "burden tables" on which you base your judgment make it appear that the Contract proposals are unfair from a distribution standpoint. Once again you are using what I believe is a publicly and totally discredited formula—family economic income. It includes the so-called "imputed rental value" of your home to determine what income class you are in. It also includes the imputed value of inside buildup of pension plans, life insurance, Kehoe plans, IRAs and 401(k)s to determine what your income is in a particular year, and it includes what is labeled as a lump-sum income that you did not report.

Now, how does the Treasury know how much income a family does not report? Can you look under their mattresses and enter their bathrooms and all the other things that relate to their lives and be able to come up with some magic figure that we know they did not report and that therefore you are going to include to determine how "rich" you are?

Mr. SAMUELS. Mr. Chairman, the distribution tables that the Treasury prepares uses a concept of family economic income. The distribution tables that the Joint Committee on Taxation and the Congressional Budget Office prepares has somewhat different income clarifiers but they are reasonably close. They all recognize that in doing a distributional analysis that you need to look at more than what is reported on tax returns as adjusted gross income because various families have other sources of income that do not show up on the tax return. For example, tax-exempt interest. For example, transfer payments, like Social Security, the part that is not taxable.

And in developing a reasonable measure, the Treasury's family economic income includes a number of items. The one that you mentioned on the rental value of homeownership is a very small part of the family economic income measure. And I do not think that anyone would dispute, from an economic point of view, that that would be a reasonable thing to take care of.

Of course, it does not reflect any view that any of the items, other than what show up on a tax return, should be subject to tax. I think it is a well-accepted approach among the economic community and shows as fairly as possible how to distribute tax proposals among income classes. As I say, I do not think our distribution tables historically have varied in any significant way from those done by the Joint Committee on Taxation or the Congressional Budget Office.

Chairman ARCHER. Well, it may seem logical to you, but to every American family that I spoke to after this concept appeared in the President's fiscal year 1993 budget, they do not understand it. They do not understand that they are richer by an amount equal to some hypothetical rental income on the house that they own and they live in. They do not understand that.

Mr. SAMUELS. As I say, Mr. Chairman, it is a very small part of it.

Chairman ARCHER. It is a significant part of it. They do not understand how you can magically create some number and say, well, you did not report this and we know you have that income, but you do not identify it. They don't see how you pull out of thin air an income number and then tell these people they are rich. No family that I have spoken to since 1993 understands that and I do not understand it, but you do.

Well, let us move on to one or two other things quickly. First, you say that all we do should be targeted, and yet the minority leader this morning said the worst thing about the income tax is the targeting that we do now changes the level playingfield. He says we should get away from that. On the one hand you testify that we should have a level playingfield and on the other hand, you say we should target everything that we do. Those two, it seems to me, conflict with one another. So I just want to point that out for the benefit of the committee.

Finally, and quickly, let's go back to the burden tables, or the distribution tables. You include a hypothetical projected amount of revenue loss resulting from the reduction in the tax rate on capital gains but you do not include one single dollar that is part of the burden or the distribution in taxes that are paid by people who unlock an asset that they would never have sold during their life. I think you will agree, in fact, I believe you will agree, that there will be many transactions that will occur at a reduced capital gains rate that would not occur at all and these will generate taxes that would otherwise not be received by the Treasury.

We can argue about the dimension of that, but certainly the unlocking effect is accepted by all economists. Why do you not include in your burden table the extra taxes that are going to be paid by those people with assets they sell that they would not otherwise sell at all?

Mr. SAMUELS. Mr. Chairman, if I can answer this question by first making one point very clearly. The revenue estimates that are prepared by Treasury, and as well are prepared by the Joint Committee on Taxation—the revenue estimates—those revenue estimates take into account behavioral effects like the unlocking that you refer to. These are the revenue tables, take in clearly, and they have for quite awhile, the revenue effects of increased sales of assets as a result of reducing the capital gains tax. So that is in the revenue tables.

The burden tables is what you are referring to?

Chairman ARCHER. Yes.

Mr. SAMUELS. The burden tables, or the distributional tables, the question of who gets the—in this case the benefit, because the Contract proposals are to cut taxes. So we are looking at who gets the benefit. These are the benefit tables. Who gets the benefit. They are not burden tables. Who gets the benefit of various proposals in the Contract. That is what the distributional table provides information on.

That table measures benefits at current realization rates. This shows how much better taxpayers are under a proposal. If taxpayers choose to realize more gains voluntarily in the face of lower rates, the extra tax that the person decides to pay voluntarily because they decide to sell their assets, is not an extra burden. That is why they are not reflected in these distributional tables.

Chairman ARCHER. But is not every transaction voluntary with a capital asset? Is not the transaction——

Mr. SAMUELS. What the distribution table is based on is realizations at current expectations, at current rates. It does not deal with realizations that might be induced, because that is up to the taxpayer. It assumes that taxpayers will realize what they have been historically, and then if they want to realize more because——

Chairman ARCHER. We will have to pursue this in more detail at a later time.

Mr. SAMUELS. We will be glad to do that.

Chairman ARCHER. But you do bring me to one subject that I want to ask you which is very, very important. Has the Treasury, since January 1993, in any way changed the model for estimating capital gains revenues or losses compared to what it was at the turn of the decade, prior to this new administration? Has any part of the model for estimating capital gains been changed?

Mr. SAMUELS. Mr. Chairman, the model has not changed. What we have done and what Treasury has always done is to update the model to reflect new information and studies that have taken place over the years. And we are always trying to update our models for purposes of revenue estimating so that we have the most up-to-date revenue estimating capacity. And I know that has been a concern of certain members and that the revenue estimating process is not up to date. The Treasury tries to stay as up to date as possible and, as a result, it would have gone through the normal adjustments that it does for all parts of its model, not just the capital gains, but for the entire model we use for estimating revenues from various tax proposals.

Chairman ARCHER. But is updating not changing?

Mr. SAMUELS. We think——

Chairman ARCHER. The model is not the same. It has been changed. You can call it updating but it has been changed as I understand it.

Mr. SAMUELS. This model is maintained by career economists at the Treasury. There has been absolutely no political input into any changes to the model. As I say, the changes reflect current information to make the model better so that these revenue estimates can be the best that we can possibly make them. And I am sure that that is what the committee would like us to be doing.

Chairman ARCHER. But it has been changed. The model is not the same as it was when this administration took office.

Mr. SAMUELS. It wasn't the same as—every—it wasn't the same——

Chairman ARCHER. I understand, but just simply has it or has it not been changed? It has been changed, has it not?

Mr. SAMUELS. The model has not. The methodology for the model has been to update the model to reflect new information and studies.

Chairman ARCHER. I understand, but it has been changed.

Mr. SAMUELS. If you want to characterize it that way, that is up to you.

Chairman ARCHER. When the Joint Committee refines and updates their model, that is not cooking the books, is it?

Mr. SAMUELS. I think the Joint Committee as well as the Treasury consistently——

Chairman ARCHER. I just want to be sure about that because——

Mr. SAMUELS [continuing]. Consistently keeps their models up to date.

Chairman ARCHER. When you update and change your model, it is "not cooking the books." And I just want to establish that if the Joint Committee updates their model and refines it to take into account information to make it more accurate, that you will agree that that is also not cooking the books.

Mr. SAMUELS. I think, Mr. Chairman, two points: First, the Joint Committee on Taxation is well known for its nonpartisan analysis of tax proposals and of revenue estimating. Second, to the extent that they make changes in their models, I think that if they are changes that are viewed as new types of analyses, we would all want to withhold judgment on what those changes are until we see them.

Chairman ARCHER. If there is a discrepancy between the Joint Committee's estimates and the Treasury's estimates on capital gains, due to their updated and refined model, I hope you would agree that is not cooking the books any more than your updating and refining your model is not cooking the books.

I am sorry, I have taken too much time, with the indulgence of the committee. I recognize Mr. Gibbons for inquiry.

Mr. GIBBONS. Well, Mr. Samuels, we welcome you back here. Pursuing the revenue modeling discussion that we had here, are there any substantial differences that you know of between the Joint Committee's model and the Treasury's model? Do you know of any?

Mr. SAMUELS. Mr. Gibbons, if you compare revenue estimates on various proposals, you will see that there are differences from time to time, and those are based on good faith differences of judgment about different issues. So to that extent, there are, from time to time, differences between the Joint Committee on Taxation's approach to a particular proposal and the Treasury's approach. And I guess that depends on the issue.

I think from my perspective we strive to have the Joint Committee's estimates and the Treasury's estimates, we think that they should—for your purposes, one hopes that they are as close together as possible. It is not always the case. And when it is not the case, we carefully discuss with the Joint Committee why there would be a difference of view because we think that the committee and other Members of Congress would be very interested in trying to understand that.

Mr. GIBBONS. I would assume that the Joint Committee gets all their raw information from you; is that correct?

Mr. SAMUELS. Correct.

Mr. GIBBONS. In other words, from the tax returns that we have and——

Mr. SAMUELS. That is correct.

Mr. GIBBONS. The basic fundamental building blocks for all of this. It is just a matter of assumptions as to what human behavior might be or economic behavior might be that we vary on; is that where——

Mr. SAMUELS. Yes, sir.

Mr. GIBBONS. From your experience in looking at these things, I know there are some differences. Are these differences substantial?

Mr. SAMUELS. Generally not. I think that where we have probably the biggest difference historically is scoring compliance initiatives; that that tends to be where you have the biggest disparity between the Joint Committee on Taxation and the Treasury. And as I say, we try to—and continue to have a dialog to try to make those discrepancies as small as possible, or those differences as small as possible.

Mr. GIBBONS. Well, I asked the majority leader the other day, Mr. Gingrich, how he expected to pay for this over a 10-year period, this—at that time it was $710 billion. And he spent most of the time killing the messenger. He blamed it on those Socialist estimators down there that you all harbor somewhere.

Can you tell me who these socialist estimators are?

Mr. SAMUELS. Mr. Gibbons, I would like to say that the career staff of the Treasury, which are the staff that prepares the revenue estimates, are a dedicated, hard-working and professional group. They have been there throughout various administrations. The people who are preparing revenue estimates now are the same folks, many of them are the same folks who were preparing revenue estimates in the Reagan administration, the Bush administration, and now the Clinton administration.

I have enormous confidence that they are going about their task in the most professional way that they possibly can.

Mr. GIBBONS. You mean to tell me you all didn't fire all the estimators down there and replace them with all people from Arkansas when you came in?

Mr. SAMUELS. No, sir. No, sir, these are career economists. They all have Ph.D.s. Many of them have spent their entire career at the Treasury. It has been a spot of, I think, real honor for many in the economics profession to work in this field at the Treasury. And as I say, I have enormous respect for their talents and their intellectual abilities and their honesty, and I do not get involved in any of the discussions about how revenue estimating is done. They come and explain what they have done. If I have a question, they will explain it to me. But we do not—I do not get involved in any way in influencing their estimates.

Mr. GIBBONS. Well, I wish you would explain to Mr. Gingrich, if you have an opportunity, that you are not harboring a bunch of Socialists down in the Treasury that are cooking the figures.

I kept a rough track of these proposals as you went through them. There are 13 tax proposals here. As I see, you sort of supported three of them. You outright oppose three of them. And then the others, I must have missed your comment on them.

Let me see, I suppose you are opposed to increasing the estate tax exemption; is that right?

Mr. SAMUELS. Yes, sir.

Mr. GIBBONS. And the home office deduction?

Mr. SAMUELS. The home office deduction is one where I think we would really like to work to deal with potentials for abuse and administrative difficulties in trying to craft a proposal on that one. So I would not—we do not oppose that proposal.

Mr. GIBBONS. How about the tax credit to reduce the marriage penalties? Do you all feel strongly about that? It is not a big figure, but it is——

Mr. SAMUELS. Mr. Gibbons, in my remarks, I indicated that this proposal lacks details on the allocation of the benefits, and I think it would be, therefore, very difficult for us to devise a proposal and then administer it. So we would like to work with the committee to investigate other means of addressing this issue.

Mr. GIBBONS. The $500 refundable tax credit for elderly care. What about that?

Mr. SAMUELS. Mr. Gibbons, on that one, the administration has made proposals on dealing with what we understand and agree is a serious problem of caring for elderly Americans, and I think our view on that is that our proposals would be more efficient and better targeted. But we would certainly like to work with the committee to try to address this difficult problem.

Mr. GIBBONS. The adoption expense.

Mr. SAMUELS. Excuse me?

Mr. GIBBONS. The adoption expense. It is not a big item, $3 billion over 10 years.

Mr. SAMUELS. I know that is not a big item, but it is certainly a very important item. And our view on that is that, as you know, there was a deduction for adoption expense. It was repealed in 1986 and replaced with a direct spending program for children with special needs. And we think that that is how we should target our resources, is to really look at the programs for children with special needs and make sure that that is working properly, rather than necessarily running the program through the tax system.

We think we will get more value for our money with the existing program. But that is certainly an area where we are willing to look at it and discuss it with the committee and try to be as constructive as possible.

Mr. GIBBONS. I don't think you took a position on long-term care insurance and services.

Mr. SAMUELS. Mr. Gibbons, the administration proposed last year favorable tax treatment of long-term care and services. So we support the goal that is in the Contract.

However, we think that there are some issues associated with the Contract's proposals. It has been revised in ways that make it, we believe, to be too generous. For example, under the Contract's proposal as revised in the bill that was introduced last week, you can buy multiple policies. So that with the way the proposal works, you can buy a policy that will give you $200 tax free if you become entitled to claim against the policy. Two hundred dollars per day tax free. And the proposal, as revised, allows you to buy five contracts so you can get $1,000 a day tax free. You can buy multiple contracts.

And we think those are the kinds of issues we need to work together on the committee to refine these proposals. And I say we think that the proposals that the administration brought forth last year are good starting points. And on this one we have significant common ground with the Contract, and basically I think we really need to work on some of the technical but very important issues as to exactly how the proposal will work and make sure it accomplishes its intended purpose.

Mr. GIBBONS. Thank you very much.

Mr. CRANE [presiding]. Mr. Houghton.

Mr. HOUGHTON. Thank you, Mr. Chairman.

Mr. Samuels, good to see you again. I have a question, because we are throwing these numbers around and they get so big it is hard to put them in perspective. But let me hone in on one—which is the neutral cost recovery.

I think you are worried about this because for the first 4 years it is a plus for the Federal Government and after that it loses money. And for the years 1995 to 2005, it loses $120 billion.

Mr. SAMUELS. Yes, Mr. Houghton.

Mr. HOUGHTON. Now, I don't know whether those numbers are right; however, we have had testimony from a Member of Congress and he used figures put together by a former revenue estimator from the Treasury Department which indicated this, and the two things just do not jibe. Maybe you can help me here.

If you put the neutral cost recovery program into effect, it would create almost 3 million new jobs, increase wages by $4,800 per employee, and provide an additional $3.5 trillion in economic activity by the year 2000. Now, if all those things happen, how can you lose $18 billion between 1995 and the year 2000 and then $120 billion for the next 5 years? I just do not understand that.

Mr. SAMUELS. Mr. Houghton, I think that those numbers you read illustrate the differences between the type of revenue estimating that has been done by the Treasury and the Joint Committee on Taxation, which is to take into account behavioral effects but not what we refer to as macroeconomic feedback effects. And the revenue estimates and predictions that you are referring to take into account, I believe, macroeconomic feedback effects.

One of the reasons and a very important reason that we do not take into account macroeconomic feedback effects is because there is not a consensus among the economists about what the effects will be with respect to any proposal, including the reaction of the Federal Reserve bank to various proposals that would potentially have an effect on the economy.

That is the reason, I believe, for example, that Chairman Greenspan testified this morning that he had serious reservations about using macroeconomic feedback for purposes of revenue estimating and the use of those revenue estimates for congressional scorekeeping.

So that is the problem. Everybody can have their views as to what is. There is a wide range of views as to what impact various proposals will have on the economy, not only tax proposals but infrastructure proposals, like building bridges and building roads. They obviously make the economy more efficient. And if we had to take into account those macroeconomic feedbacks, then you would not have to pay under our budget rules, if they produce positive results, you would not have to pay for spending programs. So those differences show, I think very much, the danger of getting into the area of using macroeconomic feedbacks, and we should stick to what we are doing, which is we use behavioral effects.

We have done that and we think it is not perfect. We recognize that it is not perfect, that there are pluses and minuses of it, but we think that it is a good conservative approach for Congress to take in evaluating tax proposals for purposes of the budget rules.

Mr. HOUGHTON. Mr. Chairman, my time is up but can I just sort of continue this for a second longer?

I don't understand what the components are of macroeconomic effects. Maybe you can teach me someday. But, however, having been in the business community all my life, I know if something went in this way I would buy more equipment and I would hire more people. And I cannot help but believe that this would not have a big plus for the economy. So you may not—you cut these numbers in half. I don't know what it is. There is something plus but it always comes out minus in some of these Treasury proposals and I still do not understand it.

Mr. SAMUELS. I think on this particular proposal, when you look at how in fact and in practice it will effect investment decisions and the opportunities for creating tax shelters, we have this example of how you can get a negative tax rate by combining borrowing and the cost recovery system; and, as a result of that, you will have uneconomic investments made, like the see-through buildings that we saw built in the eighties as part of the tax shelter frenzy.

And I think that you have to take that into account and you could wind up with a lot of uneconomic activity and this proposal could not have the effect that its proponents state.

Mr. HOUGHTON. Thank you very much.

Mr. CRANE. Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Chairman.

Welcome again, Mr. Secretary. From your responses to the Chairman, it appears as though you do not expect any dramatic differences from the estimate of the Joint Committee on Taxation and that from Treasury as relates to the Contract.

Mr. SAMUELS. Mr. Rangel, I have not yet seen any estimates from the Joint Committee. As I say, from time to time, there are differences and sometimes one is surprised. One hopes they are reasonably close. But, as I say, we have not seen any yet so I cannot really——

Mr. RANGEL. Have you had a chance to look at the CBO report which shows over a $1 trillion deficit reduction would have to be required between 1995 and 2002 if all these things are locked into place? Do you challenge——

Mr. SAMUELS. No, Mr. Rangel. I have heard—no, the CBO numbers that you are referring to, I believe, based on what I heard this morning, was that in order to balance the budget by the year 2002, there would have to be a reduction in spending of $1.2 trillion. Now, that does not take account of the Contract. And if you look at our revenue table you will see that the Contract loses approximately $400 billion from 1995 through the year 2002.

So when you add those two together, you need $1.6 trillion between now and the year 2002 in order to balance the budget and pay for the Contract.

Mr. RANGEL. But is there any difference in the estimate of the cost of the tax consequences of the Contract between Treasury and CBO?

Mr. SAMUELS. What CBO has done is just estimate what it would cost, as I understand it, to balance the budget; they have not estimated the Contract.

Mr. RANGEL. Well, historically, you say there has not been that much difference between Treasury and the Joint Committee.

Mr. SAMUELS. Well, that is——

Mr. RANGEL. What I am getting at, and I think the Chairman was referring to this, this idea of dynamic scoring. It is perceived that the majority has a method of determining the cost of the tax cuts that is inconsistent with the standards that have been set by Treasury and the Joint Committee.

Now, how do you perceive the term "dynamic scoring" as relates to how you came with this presentation on the cost of the tax provisions in the Contract?

Mr. SAMUELS. We prepared revenue estimates on the Contract using a process of which includes taking into account behavioral effects. So if you, for example, impose a gasoline tax, the estimate just does not multiply the number of gallons you expect on the baseline times the tax. It takes into account that maybe less gasoline will be used. We take that into account. And that has always been the traditional revenue estimating process, Mr. Rangel.

Mr. RANGEL. Is it possible under traditional revenue estimating processes that you use that it could be described by any other economists as being dynamic?

Mr. SAMUELS. Yes, I think that that is a fair characterization. What we don't do is take into account macroeconomic feedbacks. We take into account these behavioral effects, and in that sense it is clearly dynamic.

Mr. RANGEL. But aren't your figures dramatically different from those that support the majority's Contract as relates to the tax provisions? Aren't there dramatic differences in the costs between your dynamic scoring and what they call dynamic scoring?

Mr. SAMUELS. Mr. Rangel, I haven't seen any Joint Committee estimates, and those—let me say that the numbers that I heard before that Mr. Houghton kind of referred to, those are prepared by a private firm.

Mr. RANGEL. I wasn't talking about Mr. Houghton at all.

Now, first of all, you are basing all of this on a contract which this is supposed to be—a new contract—after the election and before the election. Have you been working on two Contracts With America or one? I understand there are some tax changes that have been made since the original legislative language was issued.

Mr. SAMUELS. Mr. Rangel, we are working with the legislation that was introduced last week. And so there have been changes, and so we are working with the revised Contract.

Mr. RANGEL. Are you saying that the majority has not associated any figures at all as to the economic impact of these tax provisions in the Contract? I mean, you haven't read anywhere from the Speaker or his representatives as to whether or not these tax provisions lose revenue or whether they gain revenue? I mean, you have just dealt with your estimators, but you have nothing to compare the majority's tax provisions with at all?

Mr. SAMUELS. Correct.

Mr. RANGEL. And in the newspapers you have seen articles that would indicate that what they are suggesting are revenue raisers. Have you read that?

Mr. SAMUELS. I have read that.

Mr. RANGEL. And you heard them say that?

Mr. SAMUELS. I have read reports of that, yes, sir. I just haven't seen any details so we could evaluate.

Mr. RANGEL. Somewhere, either in your written statement or the one that you have said, it was indicating that the capital gains tax provisions could be used for baseball cards and collectibles and antiques and things that could not possibly generate any economic growth. Could you share that with the—did you state that or did you write that?

Mr. SAMUELS. Mr. Rangel, you were correct. The Contract's proposal applies to all capital assets, including collectibles such as antiques, fine art. You said I guess baseball cards are still valued even though there has been a strike. Those types of assets would be entitled to the capital gains preferences that are in the Contract.

Mr. RANGEL. Well, you will give them time to omit all these baseball cards. I am certain that is not what they are talking about with capital gains, but I am here to work with them so, Mr. Chairman, you can make certain you get the right corrections in this capital gains thing because we don't want people to laugh at this Contract. Thank you very much.

Mr. CRANE. Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman, and welcome, Les. It is very good to see you again.

I would like to get to the proposal that the President mentioned. It is not mentioned in your testimony. At least—and I am sorry that I wasn't here while you were testifying. Maybe you mentioned it.

But this $10,000 tax credit for education that the President mentioned in his speech shortly after the election, I have a little bit of a problem with that from the standpoint that I would like to see whatever tax structure that we come up with in the Contract is primarily designed to create a climate where people would have a tendency to save money ahead of time. The $10,000 credit for education would apply I think only to people—is it only for people with $100,000 or less income or something like that? Isn't that what he mentioned?

Mr. SAMUELS. Mr. Hancock, the proposal is to permit a deduction of up to $10,000 for taxpayers with incomes up to $120,000. It phases out between $100,000 of adjusted gross income and $120,000 of adjusted gross income.

Mr. HANCOCK. OK. Well, I thought it was a tax credit. Actually it is a tax deduction if you have a child in school.

Why not give the parent a tax deduction for that child when the baby is first born to save the money to send his own kid to college instead of waiting for the government to make a grant or an aid or what have you? Why not—it has been kicked around for a long time, what I call an individual deductible education account, similar to an IRA. Why not do it and let the individual do it themselves rather than waiting until a child is 18 and then saying, well, if you are making enough money, we will let you take a $10,000 tax credit? I mean, that isn't going to benefit the average-income individual.

Mr. SAMUELS. Mr. Hancock, in fact, the administration's proposal includes the type of savings incentive that you mentioned. Our expanded IRA proposal, which I have said is like the IRA proposal that was cosponsored by Mr. Thomas and passed by Congress in 1992, permits penalty-free withdrawals for education, and we think that that is a very important part of our proposal, and it is in the Contract as well.

I think the difference between the President's proposal on this savings incentive and the Contract's proposal is that the Contract's proposal only allows penalty-free withdrawals for the ADSA, this new American dream savings account, and does not permit penalty-free withdrawals for people who already have IRAs or who want to continue IRAs. So we think it ought to be expanded. And that would be one place where we would very much like to work with the committee to try to make these savings incentives that we believe are very important to the future of the country available for families who want to save for their children's education.

Mr. HANCOCK. Let me ask you another question, then, Mr. Samuels.

I understand that we agree that there needs to be some way—and personally I think that a better way to allow people to have money to educate our children at higher education is to start accumulating that money when the baby is first born instead of when they get 18 years old.

You know, we get away, basically, with the uniform gift to minors, that by coming up with, after you make a certain amount of money, the child—you give the money to the child for an education then, but it is taxed at the parents' rate up until, what, age 14, 13 or something like that. So we have—actually, we have penalized the parents in the past couple of changes in our laws if they even try to save money to educate their children. Shouldn't we go back and address that?

Mr. SAMUELS. Mr. Hancock, I agree that encouraging families to save is very important. That is why we have had these IRAs, these expanded IRA proposals.

And I understand as well as Mr. Thomas you were a cosponsor of that proposal in 1992. And we feel that IRA proposal, which people understand—there has been a lot of advertising over the years. They understand how they work. We don't have to explain new kinds of things to taxpayers and families. And so it is a very good proposal that we would like to work on with you together.

In addition, the President's proposal to provide a deduction for education and training, we believe, is very important. That if you look at the future of this country and the need to educate our young people and to provide training if someone unfortunately loses a job or decides to move from one job to another type of job, that that is very important. And we should be investing in human capital as well and that that is a very important objective that I think we can probably all agree on. And we think that this is a good way, a very good way, to accomplish that objective.

Mr. HANCOCK. Mr. Chairman, one final question, real briefly. You know, we keep talking about capital gains taxes are only good for the rich. We keep implying—I mean, especially the minority party that used to be the majority party always said that capital gains is only good for the rich. Why don't we make it good for everybody and give a zero capital gains say up to $2,500 a year for everybody? Think about it.

Mr. SAMUELS. We would be happy to think about it.

Mr. HANCOCK. Thank you.

Mr. CRANE. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman.

Mr. Secretary, does the administration accept the premise that the cost of raising a child—the costs associated with raising a child—generally increase with the age of the child?

Mr. SAMUELS. I think that when we have designed our child credit proposal—as you may know, there is a difference between the administration's child credit proposal and the Contract's child credit proposal. The administration's child credit proposal is for children under 13. And, as I recall, the Contract's proposal are for children——

Mr. RAMSTAD. It applies to children under age 18.

Mr. SAMUELS [continuing]. Eighteen and under.

Mr. RAMSTAD. Right.

Mr. SAMUELS. And in designing the administration's proposal, we looked to try to target to those where we thought there was the greatest need and the greatest risk. And—and I think this is very important—and we took into account the budgetary effects of the proposal and the fact the administration has said and we have proposed spending cuts that will fully pay for our tax proposals.

Now, if you look at our revenue table, you will see that the Contract's cost over 10 years is $288.5 billion. As I mentioned before, the Congressional Budget Office has said that over—between now and the year 2002 it is going to take $1.2 trillion to balance the budget. You add on to that the cost of the Contract between now and 2002 as an extra $400 billion, you have $1.6 trillion that has to be financed in order to pay for the Contract and balance the budget.

Now we believe that we should pay for all of our tax cuts, and we have proposed that—actually we have proposed more spending cuts so that we have some modest deficit reduction. And in making these judgments you have to make tradeoffs. And, in our judgment, given the fiscal constraints, and we went through and did 500 billion dollars' worth of deficit reduction in 1993, we know how hard it is to come up with deficit reduction, we decided that this was an appropriate age cutoff.

Now, would we like to go higher if we have the money? We would be prepared to think about going higher, but we have to put this all in context, and there are difficult tradeoffs, and we have, as you know, very, very difficult times in cutting spending to pay for these types of proposals, and we think it is important to be completely responsible and identify your spending cuts in advance so we can be fully satisfied that we are going to pay for any of these types of proposals.

Mr. RAMSTAD. Which is precisely what we will do.

So, in other words, you are admitting that you realize that only one-third of married couples have children under the age of 13. So you recognize that this credit only applies to one-third of the families of America?

Mr. SAMUELS. I don't have that particular——

Mr. RAMSTAD. Those are the demographics.

Let me ask another question. This I think relates somewhat to the testimony of our colleague, the gentlewoman from New Jersey, Mrs. Roukema, who suggested that we cut out the war on words with respect to orphanages, to raise the level of discourse and to help in a positive way with the policymaking. And I would respectfully suggest that in terms of tax credits that we cut out the talk about class warfare.

And I don't mean to suggest that you have been initiating such talk, but, again, when you analyze the figures, only 5 percent of households, 5 percent, have incomes above $75,000 in our country, so we are talking about a very small percentage of families who have incomes between $75,000, where the administration's tax credit phases out, and the $200,000 where the Contract's tax credit begins to phase out. So to make such a fuss about the credit's lower income threshold it seems to me it doesn't serve the public policy debate well. And I would hope that we could make that recognition that we are only talking about a very, very small percentage of families, and I think we should be promoting rather than hindering social mobility.

That would be my comment. Thank you, Mr. Chairman.

Mr. CRANE. Mr. Jacobs.

Mr. JACOBS. Mr. Secretary, this idea of imputed income in the form of rent from a house you own and live in and don't rent, with all due disrespect, it kind of bothers me, too. With all due respect, that bothers me, too. Did your administration come up with that?

Mr. SAMUELS. No, sir. This has been——

Mr. JACOBS. Who came up with that idea? Which administration?

Mr. SAMUELS. This has been used since President Ford's administration.

Mr. JACOBS. Since what?

Mr. SAMUELS. President Ford's administration.

Mr. JACOBS. Did they come up with that?

Mr. SAMUELS. That is when it was developed and was used. Like I say, these are measures of distributional effects.

Mr. JACOBS. No, no I understand what it is, all too well.

Mr. SAMUELS. It has been around for a long time.

Mr. JACOBS. I understand. Well, that is right. If the Ford administration came up with it, it has been around for a long time.

Mr. SAMUELS. It has been used in the national income accounts since 1940, I have been informed.

Mr. JACOBS. Imputed rent?

Mr. SAMUELS. Yes.

Mr. JACOBS. Then what did Mr. Ford have to do with it?

Mr. SAMUELS. It was used in the national income accounts since 1940, and it was used—which is a different set of statistics—and it was used for purposes of determining distribution of tax proposals by the Treasury since the Ford administration. So it is a long time——

Mr. JACOBS. Could it go back to "Alice in Wonderland"? Would it go back that far? The average Social Security retiree today has paid in what percent of the benefits he or she will receive? Do you have that?

Mr. SAMUELS. As I understand it, it is about 10 to 15 percent.

Mr. JACOBS. That includes the interest that the contributions have generated, I believe? Five percent is my number. The average retiree today, Social Security retiree, has paid in 5 percent of the benefits he, she or they will receive, average, and that 5 percent has earned an amount equal to another 10 percent of the benefits, thus leaving the 85 percent.

Now, to the naked eye that 85 percent is in the nature of a freebie from those of us who are still paying Social Security taxes. You might even say like a lottery. Now, if you have lottery proceeds, you would have to pay taxes on them?

Mr. SAMUELS. Yes, sir.

Mr. JACOBS. Even if you lost all but 15 percent, right?

OK. So when President Reagan agreed to tax 50 percent of the Social Security benefits he agreed to include in the gross income or the adjusted gross income. He agreed that 35 percent of the benefits would be exempt no matter what your income was, correct?

Mr. SAMUELS. Yes, sir.

Mr. JACOBS. And then the 1993 act said if your income were even higher than the threshold to require you to pay taxes on just the 50 percent of your freebies—I don't mean 50 percent of the freebies but the 50th percentile of the freebie part. If your income were even higher—and the way I calculate it your income would have to be, including the Social Security benefit, on average about $66,000 a year before you would be required to include the entire amount that you didn't pay for, the free subsidy from the taxpayers in your adjusted gross income. Now, where does that money go when it is taxed? Does that go in the General Treasury?

Mr. SAMUELS. No, sir. It goes into the HI Trust Fund.

Mr. JACOBS. The Medicare Trust Fund?

Mr. SAMUELS. Right.

Mr. JACOBS. Thank you.

Mr. CRANE. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. Samuels, in your statement you were talking about the IRA, and you felt like that it should be targeted toward middle-income families. What is the gross income, annual income, for that family? What is the cap?

Mr. SAMUELS. The cap in the President's proposal is $100,000 for joint is the maximum.

Mr. COLLINS. $100,000 annual income.

Mr. SAMUELS. Adjusted gross income, yes.

Mr. COLLINS. OK. There has been mention of the $500-per-child tax credit for middle-income families. What is your ceiling there for annual gross income?

Mr. SAMUELS. $75,000.

Mr. COLLINS. Why the discrepancies in the two?

Mr. SAMUELS. As I mentioned before, in devising these proposals one had to take into account a number of factors and tradeoffs. And when we looked at the various proposals we felt that for the child credit that a $60,000 to $75,000 phaseout range was appropriate, given the scarce resources that we have to spend on tax cuts.

We think that we need to pay for all of our tax cut proposals, announce those in advance, and that they be credible spending cut proposals. And we looked at the current IRA law and felt that the appropriate way to encourage savings was basically to double the limits, which got you to the limits that we have in our proposal.

Mr. COLLINS. The discrepancy doesn't matter. Earlier this morning Mr. Gephardt referred to the $75,000, too, as an income, but he also made the comment that he would favor a lower rate across the board for all taxpayers, which includes all income levels. What is your position on such measures?

Mr. SAMUELS. I haven't seen Mr. Gephardt's proposal. What I guess I would——

Mr. COLLINS. It just simply said—reclaiming my time, let me rephrase. Let me restate it to you. He said he would favor a lower tax rate for all taxpayers. I mean, that is not hard to understand. What would be your position on that?

Mr. SAMUELS. Mr. Collins, we are in a situation where we have a serious budget deficit that faces this country, that threatens our children and grandchildren, and that is why the Contract has a balanced budget amendment that has a trillion two plus the 400——

Mr. COLLINS. I am going to run out of time. Reclaiming my time.

Mr. SAMUELS. I think what I would say is we are very concerned about fiscal responsibility, and we think that all of these proposals should be paid for. And when you—we would also like to cut tax rates. We would very much like to cut tax rates, but we have to do it in the context of fiscal responsibility.

Mr. COLLINS. OK, let's move on, then, to the cost recovery depreciation schedules. You used 10 years for a $1,000 calculator. That is kind of a little farfetched. Would you really depreciate a calculator for 10 years?

Mr. SAMUELS. That was for 10-year equipment.

You will also see attached——

Mr. COLLINS. My question is, what about 5-year?

Mr. SAMUELS. I would be happy to get you that number.

We have a 7-year example attached to my written testimony which shows how it works for 7 years. There was a 10-year example on the board. We would be happy to provide you with the number for 5 years.

Mr. COLLINS. Good. I would like to see that.

[The following was subsequently received:]

]Response to Question by Rep. Collins[

The following tables provide a comparison of the annual depreciation deductions allowed under current law with those allowed under the Neutral Cost Recovery System (CRS) for five and ten year recovery property; a similar table for 7 year recovery property was included in my testimony.

Comparison of Deductions Under Current Law and the "Neutral" Cost Recovery System

($1,000 Asset with 3.0 Percent Inflation)

- 5-Year Property -

Year	Current Law	CRS	Difference
0	200	150	-50
1	320	272	-48
2	192	203	11
3	115	201	86
4	115	216	101
5	58	114	56
Sum	1,000	1,156	156

- 10-Year Property -

Year	Current Law	CRS	Difference
0	100	75	-25
1	180	148	-32
2	144	134	-10
3	115	121	6
4	92	112	20
5	74	120	46
6	66	129	63
7	65	136	71
8	66	147	81
9	65	155	90
10	33	83	50
Sum	1,000	1,360	360

Mr. COLLINS. On the capital gains—a couple years ago I walked into a small TV rental store in a small town in middle Georgia, and a lady immediately stopped me to discuss taxes and the fact that she has a small piece of property at the edge of town. And this is not metro Atlanta. This is rural Georgia. She could have sold that piece of property, but she had chosen not to because she would have had to pay a significant capital gains tax. So what happened when she didn't sell that piece of property?

Mr. SAMUELS. Excuse me?

Mr. COLLINS. What happened when she did not sell that piece of property?

Mr. SAMUELS. Well, she obviously owns an asset, and she maintained ownership of the asset. Presumably, if she sold it to someone, that buyer would then own the asset. So the asset would either be owned by her or a buyer if, in fact, she decided to sell the property. Or she could have exchanged it for some other property. As you know, we have like-kind exchanges, and you could defer the tax.

Mr. COLLINS. That is fine, but the truth is that nothing happened. She did not sell it. She did not receive any income. Neither did the Federal, State or local governments receive any revenues from the sale because it didn't happen.

Thank you, Mr. Samuels.

Mr. CRANE. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman.

It is unfortunate, I think, this hearing came at the end of the day so many of us could not be here, and I take it some of the media has gone because I really think that this isn't the heart of the matter, but it is part of the heart of the matter, and I think your exchange with the chairman of the committee should be read by everyone, Republicans and Democrats alike.

For some reason, people who are sometimes called Conservatives kind of become Radicals. I don't think those of us here are by any means Radicals. We become Conservatives when it comes to this whole effort to estimate the impact of proposals on the deficit, and I really think before we leap we really better look. We have been through this before.

And I was thinking as we were discussing it here—take the President's proposal for an education deduction. If you use what you call macroeconomic feedback effects, I would think you could come out with an answer that that deduction would make money, no? I mean, the biggest deficit we may have today or one of the biggest deficits is in education, in training, and we have this mismatch between positions and people, right?

Mr. SAMUELS. That is correct.

Mr. LEVIN. So if you look at the macroeconomic effects of a deduction for education, presumably education will increase, will it not? I mean, more children will go to college?

Mr. SAMUELS. That is correct, Mr. Levin.

Mr. LEVIN. And the impact of that has to be positive. In fact, some people argue that more children are economically positive automatically, so I would think you could take the $500-per-child tax credit in the Contract With America and come out with a plus or at least much less of a minus than you have.

And I think all of us have to ask ourselves what is driving this discussion. I don't think it is a nefarious group within the Treasury Department. I am not sure always what it is.

I think some of us were somewhat surprised to read about the capital gains proposal so that even if you sold at a gain it could be a loss, and you could take that loss against another gain, right?

Mr. SAMUELS. Correct.

Mr. LEVIN. And I just wonder, really, if the majority side is serious about that and the revenue impact that that would have.

So I think it has been interesting, Mr. Samuels, to sit through your testimony, and I just hope that, you know, as you have done today that you will proceed in a sober way. You are a political appointee, but you bring some expertise here and that maybe we will look and listen to people who have some expertise before we jump to conclusions.

Somehow, I think the end is shaping here very much the means, and I think maybe distorting it. So, Mr. Chairman, I hope that Mr. Samuels' testimony will be transcribed rather soon—I don't know what the provision is—and that everybody on this committee will read it before we proceed to mark up bills.

Thank you, Mr. Chairman.

Mr. CRANE. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman.

Thank you, Mr. Samuels, for being here. I am sorry I was not able to join you earlier to hear your testimony. I have had an opportunity to read your oral statement. I share Mr. Levin's concern that we are at the end of the day here, and we have a lot of competing interests.

In reading it quickly and in listening to your answers to the questions that have been posed by the last couple of my colleagues, I guess I have two questions. One is with regard to the issue of progressivity. You talk about three concerns with the tax provisions in the Contract. One is fairness. One is simplicity. One is the efficiency. In terms of the progressive nature of our tax system, I guess what I would ask you, is our current system adequately progressive? Would you say that our current Tax Code and tax system is an adequately progressive system?

Mr. SAMUELS. Mr. Portman, I think that, overall, when you look at the income tax rate structure, that that is within a reasonable range, and I believe that it is an appropriate range. And also if you look at it going back to World War II you will see that it is actually today relative to periods in the fifties and sixties and seventies. It is—in terms of the nominal rates, they are lower. So I think that we have got a reasonable balance here.

Mr. PORTMAN. I just think it is an interesting discussion to get into to talk about what is the appropriate progressivity in the tax system, and it is difficult for me to judge fairness or unfairness until someone comes up with that. And I think it is difficult. It is ephemeral.

It is certainly true Mr. Collins talked about the middle-income constituent with regard to capital gains, that one could argue that capital gains will unlock as an example—which I think is one of your top examples of lack of progressivity—that the capital gains will unlock capital and help people at all levels and certainly create more jobs.

I just think to throw around the fairness, unfairness issue is difficult until we come up with a sound description of how progressive our system should be.

The other one I wanted to mention is efficiency. You talk a little bit in your testimony about how the tax system ought to be efficient and not distort economic decisionmaking. I like that. I think our whole tax system—as the chairman of this committee is apt to say, and I think he did earlier today—needs to be looked at in that light.

But I guess what I would ask you, I assume you were with the administration in 1993 when OBRA was passed by this Congress. Would you have considered that to be an increase in tax efficiency, the tax provisions in the 1993 reconciliation bill?

Mr. SAMUELS. Well, as you recall, the purpose of OBRA 1993 was to get the budget deficit under control, and I think that from our perspective we have made an important step forward. We have high growth, high employment and low inflation.

In addition, in OBRA 1993, through the earned income credit expansion, we gave a tax cut to what will be in 1995 this year about 20½ million taxpayers. So we looked in OBRA 1993 at a whole series of issues. And, as I say, deficit reduction, I think we all agree, is crucial to the future of this country. And in accomplishing deficit reduction we cut spending and we increased revenues as a package, and I feel that was an appropriate package.

Mr. PORTMAN. I would just say, in closing, that I would hope that these same standards would be applied to the administration's proposals and that we perhaps learn from 1993.

I don't have all the statistics here, but I think if you look at economic decisionmaking, how it has affected people since that time, you will find that indeed those people who are involved in subchapter S corporations, sole proprietorships, limited partners have changed—their decisionmaking has been such that they have changed their behavior, and they have done it because of the marginal rates being increased on those individuals who are again out there creating the opportunities for other Americans to work. And I would just hope that when we are applying these standards prospectively we also look back in a fair way and see what the impact has been.

Thank you for your testimony today.

Mr. CRANE. Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Samuels, for your testimony here today.

I wanted to ask you about the child tax credit for taxpayers with more than $60,000 of adjusted gross income and if it wouldn't aggravate the marriage penalty for many taxpayers.

Take—for example, I am from Omaha, Nebr. Let's take an Omaha public school teacher that is making $35,000 a year. Let's say that he or she marries a middle manager at Mutual of Omaha that is making $40,000 a year. Wouldn't the administration's policy in effect, if they were to get married, cause this couple to be penalized and lose that thousand dollars? And wouldn't we almost be sending the wrong message?

What we are trying to move away from is a policy that has been discouraging marriage. We would like to move toward a policy that is promoting marriage. Wouldn't the administration's policy have the opposite effect of what we are trying to move away from?

Mr. SAMUELS. Mr. Christensen, I think that you have to look at this issue in the context of the structure of the tax system.

We are concerned about the marriage penalty. As I say, we would be happy to work with the committee to try to figure out whether there is some way that we can address the marriage penalty issue. The marriage penalty issue arises because we tax family units rather than only workers as single persons, and we have a progressive tax system. That causes the marriage penalty.

We also have marriage bonuses so that if somebody who is working gets married to a spouse who is not working that their taxes go down. That is a part of our system. We have marriage penalties, and we have marriage bonuses.

Mr. CHRISTENSEN. But isn't it true, Mr. Samuels——

Mr. SAMUELS. And I would say that, with respect to the administration's proposal, when you look at the proposal overall, in addition to the child credit, we have an expanded savings proposal to use the IRAs, that the taxpayers know and understand where the income limits are higher as well as the education and training where the income limits are higher.

And I would also say that in looking at the proposals one should carefully consider the cost to the Federal Treasury. Now——

Mr. CHRISTENSEN. If I could reclaim my time here real quick.

Mr. SAMUELS. Well, I would just say the Contract's proposal over 10 years will cost the Federal Treasury $288.5 billion. And the administration's proposal is, over 10 years, about $90 billion. So it is about three times as large.

Mr. CHRISTENSEN. I guess returning money back to the hard-working families in this country—I don't see where that should be seen as a cost to the Federal Government. I see that as returning money back properly where it should belong. So if we use that example——

Mr. SAMUELS. We agree that deficit reduction——

Mr. CHRISTENSEN. So if we use that example of a teacher and a middle manager, that each has a child under age 13, in effect they would be losing $1,000 under your proposal. And I guess I would like to see more fairness for our working families under your proposal.

And I just think that we need to continue to look out for really who is paying the taxes here, who are paying the bills, and it is the working man and woman in America. And, you know, you are here at their discretion. We are here at their discretion. And we need to remember who is in charge here, and it is not the government bureaucrats. And we are all tightening our belts. For example, I see 14 assistants behind you.

Mr. SAMUELS. That is why I said we have to come up with $1.6 trillion, $1.6 trillion to balance the budget and pay for the Contract's tax cuts by the year 2002.

Mr. CHRISTENSEN. Thank you, Secretary Samuels. I appreciate your testimony.

Mr. CRANE. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman.

Mr. Samuels, thank you very much for being here and your testimony. I think it has been very helpful to understand the Contract With America better and its costs.

Let me, if I might, just review a couple things we have talked about today. First, as I understand it from your testimony, the cost of these tax provisions or the Contract With America would be $725 billion over 10 years.

Mr. SAMUELS. That is correct, Mr. Payne.

Mr. PAYNE. I think many of us like many of these provisions and feel that there would be things that certainly would be advantageous and popular to the people that we represent. We are really looking for bipartisan ways that we might get to the very best solutions we can, recognizing that we have to pay for the provisions. I think this committee has certainly said that they will be paid for, and others who have testified before this committee, including the Speaker, acknowledged that they will be paid for as well.

Now, you also then went on to say if you took a part of this through the year 2002, we would have a $400 billion impact that we would be adding to the $1.2 trillion that we already need to produce in order to get to a balanced budget, which I think that I and many others feel is a goal that we need to try to attain.

The question then becomes in terms of the $725 billion or the $400 billion, depending on the period of time, that one way that we could deal with that is to cut costs to that extent—and knowing what we have been through in 1993 to get the $500 billion deficit reduction, I know what a large task that is. But there is another way to deal with this, and that is to say let's change the way we estimate or let's change the scoring in some way to make these numbers less. And that is what I would like to explore for just 1 minute with you.

Mr. SAMUELS. Surely.

Mr. PAYNE. You had mentioned that the technique that is used generally takes into account behavioral aspects but does not take into account macroeconomic feedback effects. This is the same technique that was used 2 years ago in 1993 as we reduced the budget deficit by $500 billion over 5 years, as I understand it.

Is there anything instructive about what we looked at 2 years ago in terms of the $500 billion which we then estimated would be the impact of those policy decisions and what we know now a year and a half later? Were we on target? Was this a tremendously conservative technique that was used? What do we know now that might be helpful to us in this regard?

Mr. SAMUELS. Mr. Payne, we don't yet have details of exact proposals because we don't—the information isn't all available as to exactly how various tax proposals have come in in 1994 because we don't—people haven't filed their 1994 tax returns.

But I believe that there have been estimates that the deficit reduction effort in 1993—as you know, the target was $500 billion, and at least I had heard some numbers that they thought that it might actually rise to $700 billion, so that they were conservative. And I think that philosophically, at least, I believe that when we are going through these exercises we should be conservative. And if we underestimate that is great because then we will have a lower budget deficit than we thought we would and that that is the way that we should look at this. If we are wrong, we should wake up surprised and have a lower deficit than we thought, so that would be how I would look at it.

Mr. PAYNE. So you might view, then, the $725 billion as a conservative figure. So, in fact, the numbers might be realistically somewhat different from that?

Mr. SAMUELS. The numbers, yes, might be different, but I mean we used, as I say, the traditional revenue estimating techniques, and those are people's best estimate. And sometimes they come in under and sometimes they come in over.

Mr. PAYNE. So that it has not consistently been that these estimates are off by the difference between $500 and $700 billion?

Mr. SAMUELS. And, by the way, the $500 and $700 billion wasn't revenue. That was the whole package. It included all of the parts of the package, not just the tax parts.

Mr. PAYNE. I see my time has almost expired. But the bottom line here then is that, given the unknowns and given the risk associated with getting the wrong answer, that you feel that we should continue to use these conservative techniques because of the impact that it could have in the future if, in fact, our estimates were off?

Mr. SAMUELS. Correct.

Mr. PAYNE. Fine. Thank you very much.

Mr. CRANE. Mr. McCrery.

Mr. MCCRERY. Mr. Samuels, thank you for joining us and staying so long. I will try to be brief and let Mr. Cardin ask his questions or make his comments.

Before I talk to you just 1 second about IRAs, though, I just want to make a point about the administration's characterization of the EITC as being a tax cut.

In fact, much of the revenue spent on the EITC is not really a tax cut. It is welfare, workfare, if you will. And I approve of that. I like the EITC. But it is not really a tax cut for many of those folks who enjoy it because they get all their taxes back under the regular tax rules.

What they get on top of that through the EITC is not really a tax cut, it is the government giving them more money to give them a living wage. And I agree with that, but I just wanted to make that point that I don't think it is fair to count all that as a tax cut.

With respect to IRAs—and I like the administration's IRA proposal. I also like the one in the Contract. But I commend you and the administration for coming forward with what I think is a sound IRA proposal.

Besides that, though, does the administration plan to propose any other savings and investment incentives?

Mr. SAMUELS. Mr. McCrery, the President announced a package of three proposals in December, and it is my understanding that is the program of tax proposals that the administration will propose in the budget.

Mr. MCCRERY. Besides the IRA, what are they?

Mr. SAMUELS. They are a $500-per-child tax credit. They are a deduction for up to $10,000 of education and training expenses. So it is a child credit, education and training expense deduction, IRA proposal. And we are focusing this—we think it is very important to have our proposals focused to middle-income taxpayers. We think that is who needs relief the most. And we are also extremely interested and dedicated to encouraging the development of education and training.

Mr. McCRERY. So you think it is more likely that a middle-income taxpayer will save that $500 than an upper-middle-income taxpayer? I mean, if we are trying to promote savings and investment, that is my question. You used the child credit as an example of that. I am just wondering, if you are after savings and you are going to target the middle class, it is more likely then you think that the middle class will save that $500?

Mr. SAMUELS. I think we look at our expanded IRA proposal as our savings incentive.

Mr. McCRERY. I like that. I like that. My question is, is there anything else that you are going to offer to promote savings and investment?

Mr. SAMUELS. We think that our education and training—in terms of investment, we are investing in human capital. And we think that that is a very important area which we think needs extra effort for the future.

Mr. McCRERY. Anything else?

Mr. SAMUELS. Those are the three proposals.

Mr. McCRERY. OK. On your IRA proposal, I wish you would have added something that we have added to ours, which is to allow a homemaker to put aside just as much as her working spouse or his working spouse in an IRA. I think that is an unfairness in our tax system that should be corrected. I am disappointed that you all——

Mr. SAMUELS. Mr. McCrery, we would very much like to work with you on that issue.

Mr. McCRERY. Good.

Mr. SAMUELS. As I said, when we prepared our package, we had fiscal constraints as to what we could do, and we had to make difficult judgments, as this committee is going to have to do in its job of reducing the deficit, getting a balanced budget and paying for the Contract.

Mr. McCRERY. But if we could come up with something——

Mr. SAMUELS. We would be very pleased to work with you on that. We understand the benefit of it, and if we could afford it that is something we would like to—that would meet our objective as well.

Mr. McCRERY. Thank you.

Mr. CRANE. Mr. Cardin.

Mr. CARDIN. Thank you, Mr. Chairman.

Mr. Samuels, thank you for your testimony. One of the advantages of being one of the last to inquire is that I have the opportunity to listen to my colleagues and responses. I really want to compliment you on your testimony.

You have made a very strong case that if we were to act on the Contract without some significant changes that we will see the return of tax shelters, and the return of some large, profitable corporations paying no taxes at all. We also run the real risk of adding significantly to the deficit of this country. That is what I get out of your testimony.

Let me, if I might, talk about tax shelters for one moment. I remember the day when we had people making their livings off of selling investments to professionals who had no idea what the investment was, but they knew that they were guaranteed to get all their money back plus a hefty return with no risks at all.

It seems to me that the chart that you put on the table concerning the neutral cost recovery system does exactly that. A company can guarantee that the person is going to get back more than they invested plus a return with no risk at all because of the depreciable asset—you actually end up deducting more than that asset cost you, taking advantage of inflation.

You don't have to mark up your interest on borrowing costs for inflation, so you take advantage of inflation when it helps you, and you discard it when it doesn't help you. That doesn't seem very fair, and it seems like you are guaranteeing that tax shelters are going to come back.

Mr. SAMUELS. Mr. Cardin, as I testified, we are very concerned that the cost recovery proposal and the capital gains proposals would lead to an introduction of tax shelter activity which would lead, of course, to uneconomic investments, and we think that that is a serious problem and should be carefully considered in evaluating these proposals.

Mr. CARDIN. It would seem to me that one of the goals is to take tax considerations out of economic judgments, and these proposals do just the opposite. Taxes are going to drive the economic decisions if you are guaranteed a certain return rather than letting the economics of a transaction make its own judgments. I take it that is your major concern on that also.

Mr. SAMUELS. Yes, sir.

Mr. CARDIN. We run the significant risks of profitable companies being able to figure out how to use this new cost recovery when it benefits them, use capital gains treatment when that benefits them, and use depreciation schedules—so that they figure out a way of paying no taxes.

Mr. SAMUELS. As I testified, we think that there will be corporations in using these techniques who will not pay any corporate income tax or the alternative minimum tax because of the way these proposals are structured, and we will basically have a significant change in the tax reform proposals that were adopted in 1986.

Mr. CARDIN. Let me just get your judgment on the issue of simplification. I read the summary that the Ways and Means Committee prepared on the bill, and I must tell you that these summaries are very difficult to understand.

Taxpayers would have to make a judgment as to what is real property, what is personal property—and that makes a major difference—to choose whether to use capital gains treatment or the new cost recovery system, and decide which depreciation schedule to use. You add that all together, it seems like it is going to be impossible for the average person to understand how the Tax Code is going to operate. Rather than moving in the direction of trying to make it simpler, are we moving in the process to make it more complicated?

Mr. SAMUELS. Mr. Cardin, as I testified, we have serious concerns about the complexity that these provisions would add to the

Internal Revenue Code and would require taxpayers to make the kinds of judgments and decisions that you outlined.

Mr. CARDIN. Let me just get one more comment from you if I might. Treasury has estimated the cost to be about $200 billion for the first 5 years, and $700 billion for the first 10 years approximately.

It seems to me that these proposals are aimed in a way to mislead the real cost of the programs by having the first few years' revenue losses much less than the real revenue losses once these proposals are fully implemented. Why does that take place? How come we find relatively low revenue losses in the first couple years with high revenue losses after the 5-year budget window?

Mr. SAMUELS. I think it is a function of how the proposals were designed and the fact that it is also a factor of the way the indexing works.

And if you look at the revenue table you can see that the revenue loss grows for the Contract as a whole in the year 2005 to almost $120 billion, of which $32.2 billion is the neutral cost recovery. And, as you can see, neutral cost recovery grows every year in the terms of the revenue loss. And, in addition, the capital gains proposal grows every year. So it is continuing to grow out there in the later years.

And I think, in evaluating the proposals, the committee should look out into the future. That is a time when we should be, according to the Contract, balancing the budget, and you are going to have to deal with these problems in those outyears.

Mr. CARDIN. The most important thing we can do for middle-income people is get the Federal deficit down. That is costing them more than anything else.

Thank you, Mr. Samuels. Thank you, Mr. Chairman.

Mr. CRANE. Mr. Samuels, I want to thank you for your presentation. I have just one question to put to you before you get away, and that is your reference to provisions in the Contract failing to meet your standard of fairness because they reduced progressivity of the tax system. And I was wondering if you could tell me exactly how progressive the tax system ought to be in order to meet your test of fairness?

Mr. SAMUELS. Mr. Crane, my comment was in the context of looking at how the tax cuts in the Contract were distributed. And on our distribution table you will note that approximately 50 percent is distributed to those taxpayers with incomes over $100,000. And it just seems to us that when you look at who gets the benefit of the cuts, 50 percent of the cuts going to that group is disproportionate, and that is why we have trouble.

With respect to your question about how progressive the system should be, I think that is a matter of debate, as I said before. I think the system now is a reasonably progressive system.

We have had a progressive tax system virtually since the beginning of the income tax, since World War I. And it has been a feature—and I think people accept a feature of our tax system that those with ability to pay more should pay more than people with lower incomes. And, obviously, there are limits and judgments that have to be made along the way, and that is something that one can make a judgment on as you kind of look at the economy, look at the deficits, look at the future of the country as to what is appropriate at any point in time.

Mr. CRANE. So what you are conceding is the term fairness is totally subjective?

Mr. SAMUELS. I think that, obviously, it has an element of that. I think it is a question of what the perception of the public is. It is a question of how we are going to finance our government expenditures and how that should be distributed among taxpayers and families with different incomes, and that is something that this committee spends a lot of time on thinking about.

Mr. CRANE. Well, in that context, I have the figures from the tax foundation for 1992. And the top 1 percent of income earners paid 27.5 percent of the total taxes that year. The top 10 percent of income earners paid 57.5 percent. And the top 50 percent paid almost 95 percent. That means the bottom 50 percent of taxpayers paid roughly 5 percent of the total. Does that sound like a fair distribution?

Mr. SAMUELS. Let me just say I haven't looked at those numbers. And one question, of course, in looking at the distribution is to focus on also who is paying payroll taxes.

As you know, the FICA taxes phase out. We collect about a third of our total revenues from payroll taxes which cut off now in the $60,000 range or so. And our corporate—our income tax we collect about 45 percent of——

Mr. CRANE. This was exclusively income tax payments.

Mr. SAMUELS. That is why I am saying you have got to look at the whole burden. You can't just pick one thing. And, obviously, the payroll taxes, which is a third of our collections, roughly speaking, 35 percent or so, are paid by taxpayers with incomes under 60—I have forgotten exactly where the cutoff is—about $60,000.

So it seems to me when you want to look at the system you should look at the total tax burden on the whole system, and that is something that, you know, we would be happy to discuss with you and the committee.

Mr. CRANE. Well, I would love to discuss that at some later time because I have had a bill in to eliminate all taxes on business altogether on the grounds they don't pay taxes, they gather them. And, ultimately, business taxes are passed on to you and me as consumers. With that in mind, I would point out that there is no distinction based on some necessities that we all need—the basics in life such as food and clothing.

But that is for a later time, and so I thank you again for your performance today. Appreciate it.

Mr. SAMUELS. Thank you, Mr. Chairman.

[Whereupon, at 5:00 p.m., the hearing was adjourned.]

CONTRACT WITH AMERICA—OVERVIEW

WEDNESDAY, JANUARY 11, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 10:02 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

Chairman ARCHER. We have a lot of work to do so we need to get started promptly this morning.

Today, we mark the third of four overview hearings on the Contract With America. Yesterday we heard some very constructive and bipartisan ideas from the Clinton administration and from our own Members of Congress. Today we turn our attention to three panels.

The first, I am pleased to say, consists of citizens who have taken the time from their own busy lives to be with us. We are deeply appreciative of that. We have four individuals from Maryland, Kentucky, and Utah who will talk to us about their everyday experiences dealing with welfare, senior citizens, and tax issues. I want to thank all of you for traveling to Washington. I am glad you are here and I know I am joined by the other members of the committee.

One of the things we plan to routinely do on the full committee and on all the subcommittees is to listen to the testimony of American people. Some would say real American people. There are those who think we live in an unreal world up in Washington, D.C., although we know that every one of us as human beings is real. I have said that I plan to chair this committee with the taxpayer first in mind, and I think it is important that we listen to the voices of the American people.

Our second panel will consist of four distinguished experts from several leading think tanks, and our third panel consists of several guests from interested policy organizations. In advance, I thank all of them for coming.

But before turning to our witnesses, does the distinguished ranking minority member wish to make a statement?

Mr. GIBBONS. Well, Mr. Chairman, I will yield my time to Mr. Stark.

Mr. STARK. I thank the ranking member and the Chair.

As we continue to analyze the Contract With America, several points come into focus. There is really just a lick and a promise here to fiscal responsibility. The Treasury yesterday said that the revenue loss would be $725 billion over 10 years, $204 billion in the first 5 years, and there are no cost cuts yet.

It is a rather cavalier attitude toward the deficit which will make many financial markets pretty nervous, probably vastly increase the deficit, will raise interest rates, which I am sure that businesspeople with us today will be glad to comment on. And the majority may claim that they will pay for these tax cuts with spending cuts, but it seems to me if we don't cut Social Security and we don't—as I think we should—cut defense, and we obviously will not renege on the interest on public debt, the Contract has got to be paid for with spending cuts which will likely be borne by middle- and low-income Americans.

The tax proposals in the Contract disproportionately benefit upper-income families. Half the tax benefits will go to those above $100,000. That is about 5 percent of the people. So giving half of these benefits to the wealthiest 5 percent, middle- and low-income Americans will disproportionately suffer. Wealthy Americans, like Members of Congress, will gain. This probably ought to be called the Gingrich congressional pay increase because those of us who get $135,000 a year are going to disproportionately benefit from these proposals. Of course the complexities that will be added to the Tax Code and the chance for gaming and scheming for tax avoidance schemes will increase.

I am glad Newt Gingrich pointed out that I was an enemy, me and my fellow Democrats, of normal American people. The Chair has referred to real American people and I am glad to see some real American people here. I checked on the real people in my 13th Congressional District in California, which I might add is very much above the State average. They have a median family income of $52,627. About 60 percent of them own their own homes. Only 22 percent of them have a college degree. And 23 percent of them have no health insurance.

Now, these are people whose wages have been declining in a State that has been badly hurt by Federal budget cuts. And they are people whom we should concentrate on helping. And I want to ask each of the witnesses today if they will compare their situation with the real people in my district: Your income, your home ownership, and what you think your recommendations will do to help them.

My people could be helped by a tax cut that is limited to the middle class, but to increase the deficits and the debt on my children and my grandchildren to help people who make our level of salaries seems to me to be a waste of the national resources.

So I am happy to see that we are going to deal with the real issues and perhaps realistically assess how we are going to pay for this very generous gift to the rich, and so far the only way we see to pay for it is to take from the low- and middle-income people.

I look forward to the witnesses' testimony, Mr. Chairman. Thank you.

Chairman ARCHER. Any other opening statements that members might like to make may be inserted in writing in the record without objection.

[The following was subsequently received:]

STATEMENT OF REPRESENTATIVE JIM RAMSTAD
WAYS AND MEANS COMMITTEE
HEARING ON THE CONTRACT WITH AMERICA
January 11, 1994

Mr. Chairman, thank you for gathering this extensive panel of witnesses for today's hearing on the "Contract with America."

This committee has the responsibility to consider some of the most important legislation in the Contract With America -- reforms that will make a real difference to many Americans.

I believe we should make the issues we will discuss here today a top priority. Polls show that voters in last November's election were adamant that we need to ease the tax burden on American families and seniors and reform our dependency-breeding welfare system.

I am especially gratified that we will hear from American citizens who can offer a "real world" and "outside-of-the-Beltway" perspective on the proposed reforms in the Contract With America. These people must live under the laws Congress passes and can give us some much-needed, common sense advice on how the Contract's legislation would affect them.

I'm also delighted that we will be hearing from a number of distinguished panelists today who have real expertise in reducing and reforming government. Too often, past Congressional hearings have ignored these experts or refused to provide opportunities for their voices to be heard.

Many of us have worked with these scholars and policy experts in the past and know that they and their organizations have many innovative proposals that would effectively down-size government.

I thank you all for being here and look forward to your testimony.

The Honorable Phil English
Before the House Ways and Means Committee
Full Committee hearings on the Contract with America

Mr. Chairman and Members of the Committee, it is indeed an honor to be present this day as we begin a series of three Full Committee hearing on provisions contained in the Contract with America. Mr. Chairman, I commend you for your expeditious consideration of these provisions and for hosting such competent and informative individual and panel witnesses. Tomorrow, in particular, we will hear from one of the top city executives in my state - the Mayor of Philadelphia, Pennsylvania, Ed Rendell. Mayor Rendell could not be a more appropriate witness to testify before this committee as he will be directly involved in administering our reforms at the state level. In addition, he has successful administered tough yet effective reforms of his own initiation, and has handled them like a true professional.

I am equally pleased to hear the testimony of Members of this body, agency and Administration professionals, and our nations' citizens. I am eagerly anticipating hearing examples, through these witnesses, of current situations across the country which will exemplify the need to enact legislation such as the Personal Responsibility Act and the Senior Citizens Equity Act.

Mr. Chairman, this year Congress has an important opportunity to embrace the cause of working Americans. This committee will play a critical role in setting a reform agenda for the House, including mainstream welfare reform, family tax relief, and pro-jobs tax reform. I look forward to working with Members of the Committee on a bipartisan basis.

Mr. Chairman, I look forward to the following testimony, and I thank the witnesses in advance.

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Chairman ARCHER. I believe Mr. Bunning would like to introduce our first two witnesses.

Mr. BUNNING. Thank you, Mr. Chairman. It gives me a great deal of pleasure to welcome two members of our panel of witnesses, Phil and Barbara Semler, who have traveled all the way here from Richmond, Ky., to be with us today.

Although the Semlers don't live in my Fourth Congressional District, we have something else in common, that is a deep interest in seeing the Social Security earnings limit raised. We agree that it is an unfair tax on working seniors.

I am delighted to have you with us here today and look forward to hearing your testimony. Thank you for coming.

Chairman ARCHER. Mr. and Mrs. Semler, welcome to the committee. I will recognize each of you individually because each of you has an individual perspective, even though you are married to one another.

I would ask that all of the witnesses confine their opening remarks to 5 minutes. If you have a lengthier statement that you would like to have the committee look at, it can be entered into the record in full.

So if you would like to begin, Mr. Semler, please give us the benefits of your thoughts.

STATEMENT OF PHILIP M. SEMLER, RICHMOND, KY.

Mr. PHILIP SEMLER. Mr. Chairman, Congressman Bunning, and members of the committee, I am Phillip M. Semler from Richmond, Ky. Here with me is my wife of almost 45 years, Barbara. It is an honor to testify before you today. This is our first trip to the Nation's Capital. And I think I can speak for my wife as well in saying that it is a thrill to both of us.

Before I begin, I want to thank Congressman Jim Bunning for giving me the opportunity to address this committee on an issue that we feel so strongly about. As Congressman Bunning knows, I am not from his district. I contacted his office because he was chairman of the Social Security Subcommittee, because he thinks that the Social Security earnings limit is unfair, and because I felt if anyone could help us get an unfair Social Security law changed, he could.

Mr. Chairman, my wife and I are here today because last fall Congress said it wanted to hear from citizens like us and what we are—private citizens, senior citizens—who still work, and who still want to contribute something to this country that we care so much about. We believe there are so many others like us who will help who have never had the chance to address Members of the Congress.

Raising the earnings limit and removing the penalty for working would tell senior workers that Congress wants them to stay productive and keep contributing to society rather than stay at home and do nothing because they are afraid they might have to give back some of their Social Security benefits.

My story is like many men of my generation. After serving in the Navy in World War II, I got an engineering degree and went into manufacturing in the foundry business, eventually as foundry manager. Then came the recession of the early eighties. Because of changes in the car industry, the basic metal industry was hard hit by plant closings and downsizing. Many midlevel managers were let go because of their higher salaries and their age. I was one of them.

In 1982, after 30 years in the foundry business, I lost my job. I was 58 years old, with the youngest of five children still in college. Now, I am sure you can imagine how difficult it was to get a new job at 58. Companies were not hiring men of my age, salary level, and foundry experience. For the better part of 8 years, I worked at jobs that didn't pay much more than minimum wage, many times two jobs at the same time just to help maintain a decent standard of living.

Because I did not spend all my 32 years at the same foundry business, my pension was very small. My wife had gone to work when our children started school, but even with her earnings, it was rough. What should have been my peak earning years were actually my lowest, and putting money aside for retirement was next to impossible.

By the late eighties, things began to look better. We both had adequate jobs and I was looking forward to drawing money from the Federal program I had been paying into for some 40 years called Social Security. Until I lost my job in 1982, I paid in the full amount matched by my employers, and since I am working I am still paying into Social Security and will do so as long as I work, even though it will not increase the amount I will collect back.

About 6 years ago I began working as a salesman for Red Hed Oil Co. in Richmond, Ky., an independent, family owned oil business. I enjoy the work very much and work full time, but it costs me about $1,500 above Federal, State, city and Social Security taxes I pay to work there. This is the amount of Social Security benefits I will have to give back this year because I will earn over the earnings limit. It is ironic that I get a Federal tax refund which I turn back to Social Security for benefits I have to give back.

Mr. Chairman, by increasing the amount a person can earn without penalty, the Congress would help many people of retirement age who want to or need to continue to work. Many people of retirement age like Barbara and I really like to work. We also enjoy traveling, pursuing interests, and being involved in community activities, but using our knowledge and skills in the workplace is very important to us. In fact, so important that I am willing to pay the extra tax by paying back my Social Security benefits in order to work.

Unfortunately, we know many people drawing Social Security who, no matter what, will not use their skills in the work force because they do not want to pay back a large portion of what they earn. So they never reenter the work force after they start drawing Social Security or they quit when they reach the earnings limit, which is now $11,280, which in my view is unreasonably low in this day and age.

What a waste of the knowledge and talent for our Nation which desperately needs the experience, dedication, and good example of older workers.

Remember, regardless of age we are still paying taxes on everything we earn Federal, State, city, and Social Security taxes. There are no free rides on paying taxes just because you turn 62 or 65 and start drawing Social Security. We older workers on Social Security who earn over the earnings limit, we become the people paying the highest rate of taxes on our earnings.

In my own case, which I believe is quite typical, money earned after reaching retirement age goes in part to maintain a better standard of living. It also goes to investments to provide income for my wife and I when we are no longer able to work, investments which I was not able to make because I did not have the income after I lost my job at 58. In this way, we will not be a burden on our children or society as soon or hopefully ever. Whether the income from work is spent or invested, it will always help the economy.

Mr. Chairman, I am 68 years of age, and by the time the new earnings limit goes into effect in 1996, I will be 70 and able to earn all I can without penalty. So the change will not benefit me. However, for many Americans in the future, I am sure it will be of great benefit but it will benefit many Americans like me who want to stay active. For their sake, I urge you to pass a change in the law allowing older Americans to work and earn without penalty.

Mr. Chairman, and members of the committee, I want to thank you for your attention. I appreciate your interest in hearing from a private citizen like myself. I truly appreciate your efforts on my behalf.

I thank you very much.

Chairman ARCHER. Mr. Semler, thank you for your testimony to the committee. I am particularly touched by it because back in the early seventies, I initiated the first proposal to eliminate the earnings limitation and it was cosponsored in the Senate by Barry Goldwater who continued to push for it as long as he served in the Senate. I too have continued to push for it over the years, and your testimony gives great support and body to the arguments that I have made for so very many years and I appreciate your input.

Mrs. Semler, I understand you also would like to speak to the committee and please give us the benefit of your thoughts.

STATEMENT OF BARBARA SEMLER, RICHMOND, KY.

Mrs. BARBARA SEMLER. Thank you. Mr. Chairman, Mr. Bunning, and members of the committee, thank you for the privilege of speaking to you today.

My name is Barbara Semler. I am the mother of five adult children. I went to work after my children started school, but because I changed school districts and moved with my husband, I was not able to become vested for a pension. I still work part time as a substitute teacher for the mentally and physically challenged.

My husband has told you his story, which is in part my story as well. It was extremely rough financially after my husband lost his job. After putting our five children through school, college, my husband and I hoped to begin saving all that we could for a stable retirement. Our children are wonderful but the last thing we want to be is a burden on them or on society. One of the reasons we both work now is because we were not able to save after my husband lost his job and we need to catch up on our savings for the time when we will not be able to work.

We are children of the Great Depression and therefore not extravagant with our funds. It is quite discouraging for us, and other seniors that we know, to work hard and to be penalized for what we earn over an amount that is really below poverty level.

Excellent talents are being wasted because some older people on Social Security feel it is not worth the effort to work under these limitations. So they stop working rather than continue at a below-minimum wage after you consider the taxes and benefits that have to be paid back. I am particularly thinking of some men that I have taught with, and women, excellent teachers who are desperately needed as role models in our school system, especially with all the troubled children we have nowadays.

Many of those who do work after 65 are widows who have no choice. They are trying to live on Social Security alone because, in spite of hard work, there was never enough income to be able to save while their husbands were alive. Then when they work, they are penalized. I know this because my mother was one of these people and there are many, many more women like her.

We seniors have much to offer. Don't let our skills go to waste. Raise the limits on earnings and encourage these wonderful people to use their experience and skills in the workplace. Please change the law and let us know that society still wants what we have to offer.

Thank you.

Chairman ARCHER. Thank you, Mrs. Semler.

Our next witness is Craig Willett from Provo, Utah.

STATEMENT OF CRAIG WILLETT, CPA, OWNER, WILLETT & ASSOCIATES, PROVO, UTAH

Mr. WILLETT. Thank you, Mr. Chairman.

I am a small business owner and CPA, a director of a local community bank, and an adviser to the board of several other businesses in my community. In addition to my professional involvement, I also volunteer time to different organizations in helping them and their members understand and comply with the tax laws and in making strategic economic decisions.

I would like to discuss three aspects of the Contract With America. They are capital gains tax reduction, depreciation, and the marriage penalty. In addition, I would like to address two other areas that are not covered by the Contract which are of concern to me: The health insurance deduction and tax rate reduction.

The first, capital gains. I have many clients referred to me when they are starting new businesses. Some of these companies are now part of large public companies and become large employers. Others are still in the development stage. These embryo companies find difficulty finding capital. One of the reasons is that the risk-reward ratio was greatly narrowed with the passage or—with the removal of the capital gains exclusion in 1986. Many would-be investors were taken out of the investment arena.

A lot of my clients get capital from small groups of people who pool their money to invest in a unique product, idea, or service. Allowing a 50-percent exclusion of capital gains income, in my opinion, would give greater access to capital in a more timely basis. We live in an environment of rapidly changing technology, and it is crucial that these businesses have an opportunity to seek capital before they fail. I feel that the capital gains exclusion would result in the creation of many jobs.

The second area I would like to discuss is depreciation. As a business owner, one of my primary concerns is cash flow. This past year I purchased a building for my business. And even though I am an accountant, I am having a hard time dealing with the fact that the Tax Code allows me to depreciate this building in no less than 40 years. My bank then tells me they will finance it for no longer than 15 years. I am going to pay the building off 25 years before I am able to depreciate the asset. This does not make for good cash flow.

Since you can't legislate economic real estate financing, I would ask that you consider a more reasonable depreciation schedule allowing—that more closely matches a business' ability to finance its assets, thereby helping with cash flow.

From my professional analysis of neutral cost recovery, I have determined that it favors large, capital-intensive businesses. It decreases the depreciation benefits in the first 3 years for most taxpayers. A solution for small business would be to increase the section 179 expense allowance.

As a delegate to the 1995 White House Conference on Small Business, I have proposed to the Utah delegation to increase the 179 amount to a conservative $30,000. While proposing this, two other business owners on the delegation suggested that we consider a $50,000 to $100,000 179 amount.

I asked my firm to analyze the purchase of equipment by the businesses that are my clients. I submitted that as part of my testimony, and I am sure after you review these amounts you will conclude, as I have, that increasing the 179 amount to up to $100,000 would help businesses better able to match the tax deductions with their cash flow.

The third area I would like to discuss is the reform of the marriage penalty. My practice is located in the heart of a State that was founded on strong family values. From a strict tax standpoint, I have to resist the urge to advise my clients to divorce in order to take advantage of higher standard deductions and greater and more liberal tax brackets afforded the unmarried individuals.

These inequities need to be restructured to allow fair treatment to married individuals who sacrifice to hold down multiple jobs and raise families.

Another area is the health insurance premium deduction. As a small business owner, I felt abandoned during the health care reform debate. During the debate little consideration was made for the self-employed. Consequently, there is no deduction currently available for the self-employed. This lack of a tax deduction makes health insurance artificially more expensive for the self-employed.

For example, my family's health insurance premium is $413 a month. On a comparable basis with taxpayers who can deduct their insurance premiums or exclude them from their income, my health insurance actually costs me $578 per month. This is one of the most unfair treatments currently in the Tax Code.

I am encouraged to hear that this committee will attempt a 25-percent deduction for health insurance retroactive to January 1, 1994, but I don't think this is enough. The committee should not stop here but should increase the deduction to 100 percent and make it permanent, allowing equal treatment for all taxpayers.

I would like to commend this committee for considering changes in the tax law to provide tax relief for families in the middle class. I would like to ask you to consider a tax rate reduction. Since 1985, the worst of two possible things has happened to my clients. The tax base has been expanded dramatically while rates have continued to consistently rise. This has put a pinch on small business. I believe all the changes I have proposed today could be paid for through spending cuts.

I want to express, Mr. Chairman, my hope for positive actions on the proposals you are considering, and I want you to know that I am willing to work with this committee to ensure that small business is treated fairly.

Thank you.

[The prepared statement follows:]

TESTIMONY OF CRAIG WILLETT
WILLETT & ASSOCIATES, PROVO, UTAH

Mr. Chairman, I would like to thank this committee for the invitation to appear today. My name is Craig Willett, and I am a small business owner and CPA from Provo, Utah. I have a Masters Degree in Taxation and specialize in tax compliance, tax planning, and tax strategy. I started my practice eight years ago and during that time have also started several other small businesses. I currently employ five staff members and expect to double the size of my firm within the next year. In addition to my knowledge of the U.S. tax code, I have developed a hands on understanding of capital formation through my involvement in raising capital for a new community bank. I am a director of Orem Community Bank and was instrumental in raising half of the $2.5 million capital required to gain FDIC approval. As a board member I have been able to assist the bank in dealing with the strategic decisions necessary to implement a successful business plan.

My involvement as advisor to the board of several other businesses has provided me background and practical knowledge of the difficulties small business face in this country.

I have enjoyed the opportunity to testify before Congress in the past on small business issues, and I am also vice-chairman of the Utah delegation to the 1995 White House Conference on Small Business.

In addition to my professional involvement as a CPA, I volunteer time to different associations and organizations in helping them and their members understand and comply with tax laws, government regulation and strategic economic decisions.

I appreciate the opportunity to participate in this hearing examining certain provisions in the Contract with America. The Contract is a step towards less taxes, less spending and less burdensome government regulation. I believe that the implementation of certain provisions in the Contract with America will not only help small businesses but the entire nation. I am pleased that the Contract with America recognizes the role small business plays in our economy.

I would like to discuss with you five specific aspects of the Contract with America as they relate to small business. These areas are capital gains tax reduction, neutral cost recovery, section 179 expense election, increasing the estate tax exemption and indexing it for inflation, and reform of the marriage penalty. I would like to address three other areas not covered by the Contract which are of concern to me; the health insurance tax deduction, tax rate reduction and a safe harbor for independent contractors.

Specific Provisions

CAPITAL GAINS

I have many clients referred to me as they are starting new businesses. Some of these businesses are now parts of public companies and have become large employers while some are still in the development stage. These embryo companies find difficulty obtaining capital. One of the reasons they have trouble obtaining capital is that since 1986, the risk/reward ratio has been narrowed by tax policy. With the removal of the capital gains exclusion in 1986, many would-be investors who were on the margin were taken out of the investment arena.

Some of my clients are able to get investment capital from small groups of people who pool their money to invest in a unique product, idea, or service. Allowing an exclusion from taxes of 50 percent of capital gains income, in my opinion, would give greater access to capital on a more timely basis. We live in an environment of dynamic and rapidly changing technology. Access to capital on a timely basis is vital to the success of many start-up companies in our country.

There are several costs to raising capital: time, control, and resources. In my opinion, the effect of a reduced capital gains tax rate as proposed in the Contract would dramatically increase the risk/reward ratio for investment capital, thereby increasing the supply of investment capital. This in turn reduces the time frame in which start up companies can access much needed capital to maintain their uniqueness, control of their markets, and thereby maintain their competitive edge. This increased access to capital will allow small businesses to compete in our world economy. It will also allow the entrepreneur to control the destiny of his or her company, and in turn many jobs will be created. Ninety-nine percent of America's employers are small businesses. In today's service oriented economy, business owners who access investment capital will create many jobs.

I have a client who started a business eight years ago. Over the first five years, this company employed a total of ten people. The company was funded on a shoe string budget. This particular company currently employs over 150 employees and from its modest beginnings has formed a new standard in high technology for data applications in 3-D software. This company's technology is so unique that one of the international software communications giants has acquired a 30 percent ownership interest. Without creative financing, the owner of this company may not have been able to hold his dream together long enough to negotiate the capital resources he now has. In this instance, a $210,000 investment over five years has produced in excess of 100 jobs.

Being in the trenches every day I see many other companies with similar technology and/or ideas who are starving for capital. Therefore, in my opinion, exclusion of 50 percent of capital gains income from taxation would entice investment capital and would result in the creation of many jobs.

NEUTRAL COST RECOVERY

I have two different points of view on neutral cost recovery, the first as a business owner and the second as an accountant. As a business owner, one of my primary concerns is cash flow. This past year I purchased a building for my business and two start-up businesses. I have had difficulty dealing with the tax effect of recovering my investment through depreciation over 40 years. Based on original cost and considering the time value of money and inflation, I will recover 34 percent of the original cost in 1994 dollars by the year 2035. On top of that, my bank tells me that they will not finance the building for longer than 15 years. Therefore, I will pay off the building 25 years before I am able to fully depreciate it. The principal reductions I am making on this loan will be more than twice as fast as I am able to depreciate the underlying asset. This does not make for good cash flow. The depreciation appears to be out of sync with the cash flow. Since you cannot legislate the economics of real estate financing by our country's financial institutions, how about legislating a depreciation schedule that is more in line with our ability to finance assets, thereby more closely matching cash flow. A more realistic depreciation schedule coupled with the concept of neutral cost recovery would make more sense and help contribute to cash flow. In the example of my building, neutral cost recovery would allow me to recover 100 percent of the original cost as adjusted regardless of the number of years over which I can depreciate the asset.

However, neutral cost recovery, will all of its merit, brings added complexity to the tax code.

The accountant in me says that all we need are new depreciation schedules. My analysis of neutral cost recovery as proposed is that it favors large, capital intensive businesses. A solution for smaller service and labor intensive businesses is to increase the Section 179 expense election. In fact, small business owners tend to be very frugal in making capital budget decisions. Their dependence on cash flow for survival is not well served under neutral cost recovery. Neutral cost recovery as proposed would reduce the depreciation in at least the first three years as compared to the current depreciation method. This would be harmful to small business in the short run.

For many small businesses, maintaining adequate cash flow is a constant challenge as payroll and bills become due. The proposed benefits of neutral cost recovery have merit; however I question their effectiveness as it relates to small service and labor intensive businesses. It is beneficial to small business to be allowed to write off deductible costs in earlier years where the need for cash is much greater rather than in later years. Higher deductions in later years primarily benefit businesses that purchase long term depreciable assets.

SECTION 179 EXPENSE ELECTION

In addition to the concept of neutral cost recovery, small businesses need an alternative that will allow them to expense more of their purchases of depreciable assets. I would like to see a provision that would favor small businesses and not just lean toward large capital intensive businesses. I recommend that this committee consider a $50,00 - $100,000 Section 179 expense election provision instead of the current provision of $17,500. As a delegate to the 1995 White House Conference on Small Business I have proposed to the Utah delegation to expand the Section 179 amount to $30,000. While proposing this, other delegates indicated their desire to consider a $50,000 to $100,000 Section 179 expense election. As a business owner, I would certainly benefit from this proposal. However, so as not to appear self-serving, I asked my staff to calculate the average purchase of equipment for each of the last three calendar years for which we have tax information on my clients. My staff calculated the average purchase based on gross receipts calculations for each of the following years: 1991, 1992 and 1993. This excludes the acquisitions of real property and/or improvements on real property. The following chart represents these findings:

	1991	1992	1993
	Gross Receipts $3M +		
Average Equipment Purchase Per Year	$19,400	103,975	20,200
	Gross Receipts $1M-$3M		
Average Equipment Purchases Per Year	$50,600	72,450	60,760
	Gross Receipts $500K-$1M		
Average Equipment Purchases Per Year	$60,988	54,188	52,020
	Gross Receipts $100K-$500K		
Average Equipment Purchases Per Year	$19,669	18,976	19,773

In each and every classification of taxpayer, the average purchase exceeds the current Section 179 expense election amount. By increasing the expense election up to $100,000, small business owners would be able to better match cash flow to income deduction.

ESTATE TAX EXEMPTION

I support the proposal to raise the estate tax exemption from $600,000 to $750,000 and to index the exemption to inflation. The estates of closely held business owners have been dealing with estate taxes more frequently than in prior years. Indexing the exemption to inflation can prevent many mom and pop shops from being subject to estate taxes. Raising the exemption will also eliminate the need for many small businesses to argue for a lower valuation for estate tax purposes. In my opinion, one of the most uncertain areas in estate planning is the ability to value a closely held business in the same manner in which the Treasury Department may view its value. Raising the exemption and indexing the exemption will eliminate the need for many businesses to second guess how the Treasury Department will value their estate.

REFORM OF THE MARRIAGE PENALTY

In my professional practice, I have entertained many interesting questions on the selection of filing status for my clients. My practice is located in the heart of a state that was founded on strong family values. I have found myself avoiding making the recommendation to my clients to divorce and co-habitate in order to take advantage of the higher standard deduction and more generous tax brackets afforded unmarried individuals. These inequities need to be restructured to allow fair treatment for married individuals who make the sacrifice to hold down multiple jobs and raise a family.

Other Provisions

HEALTH INSURANCE PREMIUM TAX DEDUCTION

The high cost of health insurance is a major concern for small business owners. As a small business owner, I felt abandoned during the health care reform debate. In 1994 there was much discussion about health care reform and the high cost of health care, yet little consideration was made for the high cost for the self-employed. In my opinion, health insurance premiums are artificially high cost of insurance for the self-employed. I do not want to imply that insurance companies do not fairly charge the self-employed (that discussion is for another day); my point is that not having a tax deduction that is comparable to other taxpayers, the self-employed are treated unfairly.

For example, my family's health insurance is $413 a month. On a comparable basis with an employee that can deduct his or her health insurance expense, my insurance actually costs me $688 a month. This is one of the most unfair treatments currently in the tax code, and something needs to be done to level the playing field. I have many clients who do not have health insurance coverage. Their primary argument is that they cannot afford the premium and if they cannot afford the premium for themselves, then how can they offer the benefit to their employees? If these clients were allowed to deduct 100 percent of the health insurance premiums, it would certainly make health care more affordable to them. In so doing, this would actually reduce the number of uninsured.

I am encouraged to hear that this committee will attempt a 25 percent deduction for health insurance retroactive to January 1, 1994. I do not think that this committee should stop here but should increase this deduction to 100 percent in 1995, and make it permanent, allowing equal treatment for all taxpayers as it relates to the deductibility of health insurance premiums.

INCOME TAX RATE REDUCTION

I commend you for considering changes in the tax law to provide tax relief for families and the middle class. Rather than target families or certain income brackets, I would like to ask this committee to consider a tax rate reduction. Over the last several years the tax base has been expanded dramatically. Since 1986 the worst of two possible things has happened: the tax base has continued to increase while tax rates have continued to rise. This has put a pinch on small business, especially those businesses who have inventory fluctuation, seasonal businesses and those that are subject to the cyclical nature of our economy.

I favor deficit reduction and do not want to propose tax provisions that would increase the deficit. However, I believe that government spending is out of control and whatever fair treatment I have asked for today, whether it be tax rate reduction, depreciation allowances or fair treatment on health insurance premiums, these can be paid for by cuts in spending. Small business owners should not be subject to unfair treatment of the tax code for the sake of our country's deficit. Since tax laws are to be revenue neutral, the money to pay for the provisions I have asked for should come from reduced spending. The cost of any of these proposals should not be used as a deterrent for the passing of fair and reasonable legislation, especially when spending is out of control. As a business owner, I have learned to budget and manage within my means. Our government is in the process of learning to do a better job of this and I would encourage this committee and this Congress to look for areas that would further reduce spending.

INDEPENDENT CONTRACTORS

Last February, I appeared before the Select Revenue Subcommittee of the Ways and Means Committee on the subject of health care reform. One of the major issues in the proposed health care reform was the treatment of independent contractors. I would like to encourage this committee to fully examine the definition of independent contractor. In health care reform, some proposals contemplated granting the IRS administrative authority to define independent contractor status. In my opinion, the 20 point common law test, albeit unclear, is a better alternative that granting the IRS carte blanche authority to define worker classification, be it employee or independent contractor.

Mr. Chairman, thank you for this opportunity to testify before the Ways and Means Committee. I would like to express my appreciation for the committee's willingness to consider less taxes, less spending and less government regulation. As an active and involved citizen, I want to express to you my hope for positive action on the proposals before this committee. I believe that the proposals being considered will have positive impact on the lives of many Americans. I want you to know that I am willing to work together with the committee to ensure that small business is treated fairly regarding the legislative issues before you and that small business owners will have greater access to capital, lower taxes and less regulation as a result of your endeavors. I hope that you will consider some of the specific provisions that I have proposed to help you in your work as representatives of the people.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Willett, thank you for your input.

Our last witness in this panel is Virginia Kellogg from Maryland. We are happy to have you before the committee, and we would be pleased to receive your thoughts this morning.

STATEMENT OF VIRGINIA KELLOGG, OWNER, KELLOGG STRESS INSTITUTE, MITCHELLVILLE, MD

Ms. KELLOGG. Thank you, good morning. I am Virginia Kellogg, owner of the Kellogg Stress Institute in Mitchellville, Md., a small business. I have been in business for myself since 1982, providing stress education and stress management training.

When I look at our country today, I see an American public that is highly stressed. This stress manifests itself in violence, crime, depression, and major physical disorders.

Why are people so stressed? Because they have lost their power. The sense of empowerment that individuals and families once possessed now rests with the Federal Government. Yet people feel that no one in government is listening to what they say they need and want. What Americans do not want is to surrender any more of their freedom or their power to the Federal Government.

What should the government's role be? Government should help equip people to solve their own problems. It should offer people opportunities to improve their lives, but it should not control people's lives. Government should not do for people what free people can do for themselves. American people need to be empowered to make the decisions that affect their own lives. People feel empowered and content when they have a say in what happens to them.

Furthermore, authority needs to be decentralized and given back to the State and local governments because these governments are closer to the people who are in need and can better help solve their problems. The Federal Government needs to get back to doing those things the authors of the Constitution intended it to do and it needs to turn away from doing those things that are not called for in the Constitution.

In the past, the Federal Government has been a savior of civil rights for African-Americans, allowing doors of opportunity to be opened in many areas. Many African-Americans migrated to northern cities from the South just to find that good government job. Federal jobs were available when prejudice and racism made getting other jobs impossible. Indeed, the Federal Government did and still does offer good job opportunities, but out of that migration of African-American government workers decades ago grew a dependency on the Federal Government that is not unlike the overdependency today on welfare, but with a different slant.

We have allowed the government to parent our children, discipline them, care for them, and feed them. In too many cases over the years, we have learned not to do for ourselves but to be totally dependent on the government. This dependency must be redirected. It has been and is harmful because a person who is dependent financially is also dependent mentally. Mental dependency breeds anger, hostility, and a desire for power that often is channeled into unsavory acts.

It will take some tough love to teach people to be independent and self-sufficient and to fend for themselves, learning to use resources that are available, and learning self-discipline and self-control. Our moral values must be redefined and we must go back to basics. I say we have had enough enslaving handouts.

The Federal Government has created a subculture through our welfare system. It has encouraged having children when young girls and boys are neither mature nor responsible enough to parent. Individuals in this subculture are ill educated and lacking in marketable skills, and they play a passive role in society. Consequently, the children that are born into this subculture are limited in their growth because their parents can only give to them according to the parents' own limited experiences and exposure. These situations have created an environment of hopelessness, a trap where there is no education and no marketable skills, so you have another child and another, until having children becomes your career.

Many people on welfare do not want to be there. They feel entrapped by the system. They want out. The Federal Government's welfare regulations have run fathers out of their own homes, instead of helping them to stay with their families and take responsibility for them.

I recall what happened to unwed mothers when I was growing up in rural North Carolina some years ago. Families took care of their own, there were fewer unwed mothers, and discipline was at the forefront of child rearing.

In today's society, unwed mothers get cash benefits for having children. The Federal Government has seemingly taken away the families' responsibility. Consequently, an apathy has set in that causes people to look to the government for everything.

I was speaking with someone the other day about America's welfare system. They told me that the Federal Government has so many rules and regulations for the State government to follow that service to clients, that is moving them off the welfare roll into jobs programs, becomes stagnant while time and energy go into completing Federal forms. There needs to be a shift away from massive paperwork and a shift toward getting results.

People could get off welfare if the Federal Government would eliminate some of the redtape that has piled up over the years and that now causes welfare recipients to feel powerless, angry, and discontent.

The welfare system has done nothing to help people develop and grow. The system has, in fact, enslaved people. People progress through self-initiative, self-drive, and when needed, help from others. We need programs that help people help themselves, not programs that take away people's self-determination and self-esteem.

Life without goals, without purpose, and without love produces anger, hostility, and violence. We can and must rear fewer violent children. I say it is time to get back to basics.

I believe that the right of the individual to achieve his or her best while respecting the rights of others is the source of our Nation's strength; that government activities should be limited to those things that people cannot do at all or cannot do so well for themselves; that those who cannot provide for themselves should be assisted by both government and society, and that every effort should be made to help people become self-supportive, productive citizens with pride in their independence; that equal rights, equal justice, and equal opportunity belong to all, regardless of race, creed, or sex; and that the preservation of our Nation and the security of our citizens depend upon the upholding of the Constitution, the adherence to and enforcement of our laws, and the justness of our courts, and that respect for the Constitution, the law, and the judicial system is the responsibility of every individual.

So, let's cut the redtape and give the power back to the people so we all can become less stressed, more content, and committed to pursuing a better quality of life.

I thank you.

Chairman ARCHER. Ms. Kellogg, thank you for your excellent testimony.

Thank you, each of you, for taking the time out of your own lives to give us the stories and input that I think represents the backbone of America.

People are willing to take on personal responsibilities with the ups and downs in life and they believe that government really does not help to provide freedom but rather takes away from freedom. So I am very grateful to you.

I yield my time for questioning to Mr. Crane.

Mr. CRANE. Thank you, Mr. Chairman. I want to congratulate all the witnesses today.

However, Ms. Kellogg, I want to tell you how impressed I am with what you have to say.

I was brought up in the same kind of family you were, with religious values and it was hard scrabble and we all worked. My dad when he went to college ate leaves at times just to have something on his stomach because he couldn't afford to pay for a meal, and brought us all up with those values that said you have an obligation to help those less fortunate than yourselves, and we were taught to tithe, to give 10 percent of what we earned to those less fortunate.

Welfare has been a part of our entire national experience going back to the colonial era. And up in the Boston area in the 1630s, if I lost my job, then a local government official came to the Chairman, who lived next door to me here, and Mr. Shaw, who lived next door to me there, and he would say, Phil Crane is out of a job, he has a family, you two have the obligation to support him until he gets back on his feet. It created a whale of a compulsion to get a job in a hurry and get out of that kind of dependency.

And you are very right when you point out what can happen in our welfare system today when you have a rebellious teenage daughter—and I have seven daughters. If she gets pregnant out of wedlock today, all of a sudden she can move out on her own, she has got her own health care system, her own living quarters, aid to families with dependent children, food stamps, and I am sure it is a positive incentive to destroy all the values that we believe in.

Your point is so well taken about trying to give this authority back to State and local communities. Historically, that is where it resided. A lot of Americans don't realize that the National Government never flirted with welfare until the Great Depression. And I am embarrassed to say that Herbert Hoover made the first tentative gesture before he went out of office. But Franklin Delano

Roosevelt in 1935 in a State of the Union Message said, "to administer this kind of assistance is to administer a subtle narcotic and destroyer of the human spirit." Think of that. That was FDR in 1935.

And he went on to say in that State of the Union Message, "The National Government must, the National Government shall quit the welfare business." Now, that was an awesome problem because of the unemployment rates coming out of the Depression.

The fact is I was interviewed the other day on the steps of the Capitol about homeless people who were putting on a demonstration. And I said, you know, one of the problems is when the National Government takes it over there is a depersonalization that occurs because suddenly that person is not my responsibility. That is what I pay my Federal Government taxes for. We have all this welfare assistance, you know. The Federal Government is supposed to be there. The fact is those people in our community are our responsibilities.

One of the consequences that you touched upon in your testimony that I couldn't agree with you more on is the destruction of all of our traditional values. Walter Williams is a black economist over here at George Mason and a dear friend. I am sure you know Walter.

Walter told me that back in the midtwenties in New York, 85 percent of black families were still together and they looked after their children. And today they are projecting that by the year 2000 in our major cities, 85 percent of black children are going to be illegitimates if these trends aren't reversed. You bring a child up in a handicapped circumstance like that with no future and the deterioration of our educational system where he is illiterate, he has nothing to look forward to, and he has the enticement of gangs and drugs and so forth. I think it has had exactly the effect that Franklin Delano Roosevelt talked about.

And so I would hope that we could follow your suggestion here and try to figure out how we decentralize, take these responsibilities back to the local level where they never should have left in the first place and we can start rebuilding.

The other point you make is absolutely on target. We have created a Federal plantation system in our major cities, and the fact is we have in the process destroyed those values of black people in our society who historically had as strong a base of religious values and as family oriented as any group that you could find in the United States.

We have been working perhaps with good intentions but it has been a tremendous failure. Our welfare system has corroded all those fundamental values. And so I just salute you. I mean you are an exception, but you are in the vanguard of the future and so thank you for coming and testifying.

Chairman ARCHER. The gentleman's time is expired.

Mr. Gibbons.

Mr. GIBBONS. Ms. Kellogg, I believe, if I understood you correctly, you were complaining about the man in the household rule; is that correct?

Ms. KELLOGG. I am sorry. I am not hearing you clearly.

Mr. GIBBONS. You were saying that the welfare system was destroying families by prohibiting a man in the household.

Ms. KELLOGG. Running the man out of the house.

Mr. GIBBONS. Well, you will be happy to know that has never been a Federal regulation, that has been a State regulation. And that finally in 1988 this committee, and the Congress concurring, outlawed that State regulation.

So since 1988, the States haven't been able to drive the man out of the household and destroy the family. You ought to go to the Governors and the State legislatures to complain about that. We acted on that. We never employed a regulation against a man in the household. That has been the 50 States taking that prerogative themselves. We outlawed it here in 1988.

Mr. and Mrs. Semler, I feel very sympathetic toward you, of course, and it is costing me about $70,000, working penalty, and so I know how you feel.

Mr. Willett, yesterday the Secretary of the Treasury was in here—Assistant Secretary of the Treasury, saying that he thought that indexing of capital gains for inflation would be an excessive bookkeeping requirement upon the asset holder.

As a CPA, do you have any views on that?

Mr. WILLETT. Are you talking about the indexing of neutral cost recovery for depreciation or are you talking about capital gains?

Mr. GIBBONS. Capital gains.

Mr. WILLETT. Capital gains. Indexing anything is actually more complex. I mean, as an accountant it would be great if I wanted to be self-serving, but actually as a taxpayer it is more complex and more burdensome to try to figure that out every year.

Mr. GIBBONS. All right. Thank you.

That is all the questions I have right now, Mr. Chairman.

Chairman ARCHER. Is Mr. Thomas here?

Mr. Bunning.

Mr. BUNNING. Thank you, Mr. Chairman.

Mr. and Mrs. Semler, I would like to raise a point. The day before yesterday, the Commissioner of Social Security, Shirley Chater, testified before my subcommittee that she favored raising the earnings limit a moderate amount. And I asked her specifically what she thought was a moderate amount and she said $1,000 over 5 years. That is a $200 per year increase.

I just would like to get your opinion about that and what you consider a moderate amount, because, in my opinion $200 a year for 5 years is not a moderate amount.

Mr. PHILIP SEMLER. I certainly agree with you, sir. That wouldn't even protect us from the cost of the living increase really, this $200.

What I would like to say is I think that—let's eliminate it altogether. It makes more sense to me to do away with this limitation on the income for a number of reasons. I think it would allow us to earn this money regardless of your profession and, in turn, the Federal Government would still collect a lot of taxes back by these people who drop off the ability to earn or get into the work force to earn this.

I think $200 a month—$200 a year is about what they have been raising it the last 10 years, and so that really this proposed rule isn't really changing the law as it stands right now.

Mr. BUNNING. Last year it went up $180, so she is proposing a $20 increase as the moderate increase that the administration wants.

Mr. PHILIP SEMLER. This will not entice people to keep in the work force, I am afraid, and this is what—one of the reasons we are saying that.

Mr. BUNNING. Let me ask both of you. Both of you work and you know many seniors who are also working. Mrs. Semler, you have mentioned some, including your own mother, who was a widow.

From your experience, how many of your contemporary seniors who are working are doing so because of need, financial need?

Mrs. BARBARA SEMLER. It would be hard to put a number to that but I know of many widows that are out there standing in stores or even in McDonald's, in places like that, trying to earn enough money to get by. And they are very limited in their income because of this flaw and yet they have to do this or they can't live. They have no one to depend on and they are left out there to fend for themselves at an age where they should be able to sit back and enjoy themselves a bit. They are under great stress.

Mr. BUNNING. From your experience—how many of those seniors that you know try to limit their earnings in order not to lose Social Security benefits? Half? More than half? Or what percentage of those that you know are working have to stop sometime during the year because they are approaching the earnings limit and are going to get penalized if they go over it?

Mrs. BARBARA SEMLER. Possibly half. Possibly. Some of them continue working because they are afraid they will lose that job and at their age they are afraid that no one will take them back, so if they have a job, they keep it as best they can.

Mr. BUNNING. So they throw themselves into the higher tax bracket, the penalty that comes upon them?

Mrs. BARBARA SEMLER. That is right. To go out and try to find a job at our age is very, very difficult, and once you get it, you don't let go.

Mr. BUNNING. Do you know any seniors who don't work at all because they are afraid of losing some type of Social Security benefits?

Mrs. BARBARA SEMLER. Yes, yes. I know a few teachers that are doing this, at college level also.

Mr. BUNNING. Mr. Semler.

Mr. PHILIP SEMLER. I just talked to a man in the last 2 days who has not drawn his Social Security and he is 70 years old. I said, why did you wait until 70? He says, so I won't ever have to pay any money back. I said, do you realize how much money you might have lost already? He says, well, I am still living.

So he looked—I think he was working on the principle that he just didn't want to get involved in it and get into the fact that the government might come and say you owe so much more money back to us. So I think—and this has happened to us when we do pay our money back.

Mr. BUNNING. I want to thank you for traveling back up from Richmond, eastern Kentucky, and being here.

Mr. PHILIP SEMLER. We are pleased to be here. Thank you for the opportunity.

Chairman ARCHER. Just very quickly, there is another aspect of this that is an unseen major problem. It creates the single biggest administrative headache for the Social Security offices around this country of any other part of Social Security, and my own mother-in-law who has continued to work, as you have, for a lot of the same reasons that you continue to work, had a stack of filed papers this thick trying to work out the problems on this earnings limitation. It is a morass of redtape. Now, that doesn't serve anybody.

Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman.

Mr. Semler, I appreciate your comments. I am one of the few people on the committee that is 65 years old and would be drawing my Social Security if in fact I wasn't employed here in the U.S. Congress, I guess.

Do you think that there should be some consideration given to means testing of Social Security? We keep hearing that people making $100,000 a year hadn't ought to draw their Social Security. What is your opinion of that?

Mr. PHILIP SEMLER. I will let you know if I win the lottery. Social Security, in my opinion, was set forth to give a retirement program so people could be independent. I think each person when they get to this age, and depending on how much wealth they acquired, it might be a judgment call on their part. And I know that is sort of evasive, but at the same time a man whose investments are paying him retirement money right now, $200,000 a year, I don't think that he would really miss the Social Security, but at the same time I can see where a man says, I paid into it, I think it is mine.

Mr. HANCOCK. Well, I don't want to cut you off, but basically what I think you are saying is if that individual voluntarily wants to donate that money or contribute it to some charitable cause or give it back to the government, then he should have that option, but that the government should not say just merely because you have been successful and you have accumulated some assets you should not draw your Social Security. Is that basically it?

Mr. PHILIP SEMLER. That is right. Because I think that is the incentive our country has been based on, is to obtain this.

Mr. HANCOCK. Thank you.

Mr. Willett, you talked about the greatest concern currently is estate taxes. I am sure you analyzed the situation where people have been successful, they start wanting to distribute their assets ahead of time or prior to the time they get into the estate tax.

Have you ever analyzed what it costs a family to transfer the ownership to the family members prior to death, for instance, say you own a business, you want to transfer that business to a member of your family, so for every $100,000 that you sell it for, the government ends up with about $80,000 by the time the receiving member earns the money to pay that $100,000.

Have you ever come up with the figures on what it actually costs?

Mr. WILLETT. I have never actually calculated that but that would be an interesting study. But I think your estimate of approximately $80,000 would be correct. Plus, a lot of people have a hard time—just a general litmus test in looking at my clients—have had a hard time of meeting the cost of having then to sit down with an attorney to try to transfer the assets. And going through those expenses on top of it creates a lot of distraction from the productive use of their time.

Mr. HANCOCK. Not only productive use, but it gets to the point of where—how do you value it? A small family held operation that is dependent upon those personalities, but yet Internal Revenue is going to come in at some time in the future and is going to say, well, this is what the price was. In fact, it gets to the point where it is just almost impossible to transfer the assets, and if you do transfer it, the government ends up with more money out of the deal than anybody else.

Mr. WILLETT. In addition to that, Mr. Hancock, I think it goes even further in that it creates a difficulty on the second generation that is taking that business over to be able to finance it and pay the estate taxes that can be anywhere from 35 to 55 percent of the value of the business.

Mr. HANCOCK. They usually have to go deeply in debt to keep that business going.

Mr. WILLETT. Right. And in so doing, think of that $100,000 or $200,000 of estate taxes that they pay, how many jobs would that have paid for in that first year where the next generation took over the business and how much more could the business have expanded and created more taxpaying dollars through income taxes rather than through estate taxes.

Mr. HANCOCK. Ms. Kellogg, we have got just a second here, I don't think you will have time to answer this one, but the question is, in your view, what is the best way to move people off of welfare?

Now that one is the question I think that we have got to answer here in the U.S. Congress, and I don't think you can answer that in 5 minutes. In fact, we haven't got that much time. I think that is the key, that one question. What is the best way to move people off of welfare?

Ms. KELLOGG. Do you want me to answer that?

Mr. HANCOCK. If you can answer it that quickly, yes, ma'am.

Ms. KELLOGG. I certainly think I can give you a quick answer. I think we should do away with welfare as we know it, particularly I think that we know it does not work so we should start weaning people off welfare and——

Mr. HANCOCK. Are you talking about completely canceling our welfare system and say, look, folks, you are on your own?

Ms. KELLOGG. I think that is what we should be looking at. We cannot do that overnight. We cannot just leave people hanging, but I would certainly think in 5 years' time we can certainly have canceled the welfare system that encourages mothers to have babies out of wedlock because they know that I don't have to worry about it because I can go and I can get food and I can get cash benefits and I can get housing.

And then, of course, what we find, and I have had lots of experience in working with welfare mothers in my business and having contracts and trying to help them get off of welfare, and I know the population very well. I identify with them very much, and I have talked with them very much and I feel that the welfare system as it is has been more harmful.

No, we cannot just shut it down tomorrow, but I certainly think in 5 years' time it should be shut down, and I think the kind of welfare system or assistance that people would get would be based more on where the Federal Government should be and let the States determine what the needs of their people are and how they will take care of it.

Mr. HANCOCK. Thank you, Ms. Kellogg.

Chairman ARCHER. Mr. Stark will inquire.

Mr. STARK. I was going to yield, Mr. Chairman, to Mr. Rangel.

Mr. RANGEL. Thank you, Mr. Stark. And let me thank this entire panel for the contribution that you have made, especially you, Ms. Kellogg, for your very forceful testimony.

Exactly what is it that you are doing at the stress center?

Ms. KELLOGG. What do I do at the stress center? Well, I am a small business, and, as I said, I have been for 12 years. I teach people how to manage their stress, how to deal with the stress of life, and that that stress source can be anything. Everything in life can be stressful.

Mr. RANGEL. You indicated you also work with some people that have been on welfare. Do you have these as your clients?

Ms. KELLOGG. Yes. I have had a contract through Prince George's County, Md., for the past 5, 6 years helping welfare clients to become self-sufficient, teaching them empowerment, teaching them how to overcome barriers to self-sufficiency.

Mr. RANGEL. How many of your clients are welfare recipients or former welfare recipients?

Ms. KELLOGG. Have I had?

Mr. RANGEL. Right now. What percentage of your students or clients are welfare recipients?

Ms. KELLOGG. What percentage? Well, up until this year, I would say 90 percent of my clients were. Up until this year.

Mr. RANGEL. And with these contracts, you get it from a county in Maryland, I mean these are county contracts that you get?

Ms. KELLOGG. Well, the way the system is set up, it is through the Private Industry Council through the economic development with the State of Maryland, through the Department of Human Resources, through the Federal Government.

Mr. RANGEL. I guess what I am asking is 90 percent of what you receive in terms of funds are public funds?

Ms. KELLOGG. Ninety percent of the funds that I received came from public funds, yes.

Mr. RANGEL. So indeed, your institute is dependent on the government for survival?

Ms. KELLOGG. No, my institute is not. As a matter of fact, I have no contracts with the welfare project at this time. So my institute is—my institute is open to the general public and it has never ever been dependent in the 12 years on government.

Mr. RANGEL. I am misunderstanding you.

Ms. KELLOGG. Yes, I think you are.

Mr. RANGEL. I am trying to find out—how many of the people that you alleviate stress—what do you do for the welfare recipients to alleviate the stress?

Ms. KELLOGG. What I do for the welfare is to help them to understand what it is going to take for them to become self-sufficient.

Mr. RANGEL. Now, my question, which I probably didn't word correctly, was how many of the people that attend your institute come to your institute under contract from local government? That was my question. I misunderstood you. I thought you said 90 percent.

Ms. KELLOGG. Let me explain to you what my business is all about for just 1 minute, please.

I contract with Federal Government, State and local governments, private industry, anyone who is willing to pay to come——

Mr. RANGEL. Ms. Kellogg——

Ms. KELLOGG [continuing]. To help me to train them. So I go to them.

Mr. RANGEL. I understand. They got to cut me off and I just want to find out if you had to add up all of your clients that come to you for you to train or alleviate the stress, I am trying to find out how many of them come from under contract from any type of government.

Ms. KELLOGG. 1994—by 1995, I would say almost zero.

Mr. RANGEL. In 19—when you said 90 percent, what were you referring to?

Ms. KELLOGG. I was referring to a period from 1989 until 1993. I had a contract with the Private Industry Council of Prince George's County to provide for Project Independence which came under the JOBS program to help——

Mr. RANGEL. Right now who are your clients, because when you said——

Ms. KELLOGG. Right now?

Mr. RANGEL. Right now who comes to you for help?

Ms. KELLOGG. Anybody who can pay for my services.

Mr. RANGEL. How are you paid for—no government money is involved right now with your services, right?

Ms. KELLOGG. Well, I—no government moneys are involved in the U.S. Postal Service——

Mr. RANGEL. You are not under contract——

Ms. KELLOGG. I get—I do a lot of work for them and——

Mr. RANGEL. You are not under contract with any local, Federal, State, or government agencies, are you?

Ms. KELLOGG. No, sir, I am not.

Mr. RANGEL. So the individuals who come to you are private-sector people coming to you for your services.

Ms. KELLOGG. All people. Private sector. Individuals. I have done work for the Federal Government——

Mr. RANGEL. You don't deal with welfare recipients any longer?

Ms. KELLOGG. I do not have a contract with welfare recipients in 1994. I did up until 1993.

Mr. RANGEL. But all your people come from the private sector. What I am trying to find out is whether or not you do business with any type of government. The answer is no.

Ms. KELLOGG. Sir, I think I said I do business with anybody who is willing to pay for my services.

Mr. RANGEL. I am not saying would you. I am trying to ask, Ms. Kellogg, and maybe you can——

Ms. KELLOGG. I am not understanding you.

Mr. RANGEL. At this point in 1995, or in 1994, did your institute receive any payment from any government agency for services provided?

Ms. KELLOGG. If so, very little.

Mr. RANGEL. Thank you.

Chairman ARCHER. The gentleman's time has expired.

Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman. I want to thank all of these witnesses. It is very refreshing to receive real world input, which this Congress needs a lot more of, and I certainly appreciate hearing about your experiences and your real world knowledge.

Let me ask you, Ms. Kellogg, and despite my good friend's attempt to impeach, I think you certainly are experienced and have some very valuable insights that this committee and this Congress needs to put into our reforms as we attempt to do something about the welfare mess in America, a system that is doing a disservice to the underclass as well to as to the taxpayers.

Let me ask you, if I may, Ms. Kellogg, how long in your judgment should welfare, especially AFDC cash payments, how long should these benefits be available to families in need?

Ms. KELLOGG. Two years. I tested this with about 2,500 to 3,500 welfare recipients and that is what they said, 2 years.

Mr. RAMSTAD. Two years is an adequate amount of time?

Ms. KELLOGG. Yes, it is.

Mr. RAMSTAD. Do you agree or disagree that some form of a lifetime cap is necessary to force people off of welfare and on to the work force?

Ms. KELLOGG. When you say a lifetime cap, you mean to say you can receive services for 2 years, 3 years, 4 years, 5 years?

Mr. RAMSTAD. A maximum number of benefits.

Ms. KELLOGG. A maximum amount of benefit years?

Mr. RAMSTAD. Right.

Ms. KELLOGG. I would say in many cases, yes, but I think we always have to look at some unusual circumstances and we always have to make allowances for unforeseeable or unusual circumstances so there should be something that would allow people for unforeseeable kinds of things occurring, but for basically—absolutely, yes.

Mr. RAMSTAD. My final question to you, Ms. Kellogg, assuming we can reform welfare to actually promote family unity instead of providing disincentives for families to stay together, and assuming we can reform welfare to a workfare system of incentives to work rather than the present system which has built-in disincentives to work and be a productive taxpaying member of our private sector, how long will it take for these reforms to translate into recognizable behavioral changes?

Ms. KELLOGG. Well, you know, as much experience as I have had, I have seen behavior changes in as little as 3 months and some it took longer. So it depends on where the person is. I don't know if that answers your question. But many people already, I mean they just don't know how to get out of the trap. What kind of life can welfare offer one?

Mr. RAMSTAD. Thank you very much, Ms. Kellogg.

Mr. Chairman, I think you said it. All people are ready. They want to get out of this trap and it is a trap.

As a former criminal justice act attorney who represented indigent people exclusively for over 5 years, and one who understands this problem, I recognize it as such, and hopefully the majority of this committee will and of this Congress, so thank you again, all of you, for this really helpful testimony.

Chairman ARCHER. Mr. Coyne.

Mr. COYNE. Thank you, Mr. Chairman. I also would like to welcome the panelists and thank you for your testimony.

Mr. Willett, in your testimony you indicated that you think that we ought to change the Tax Code and perhaps reduce taxes, and that we ought to pay for that by reducing spending.

If we pass a balanced budget amendment, we are going to have to reduce spending by over $1 trillion by the year 2002. We need help in finding ways to cut spending if that is enacted, and I wonder what your suggestions would be for any kind of reduction in spending programs?

Mr. WILLETT. I can figure out—in my professional life I can figure out the Tax Code but I have a hard time figuring out all of the government programs and what the Federal Government is really all about.

On the plane out here I read an article that indicated 300 welfare programs are being proposed to be reduced to 8 programs. I know in my business that if my revenues were to decrease next month, I know the first five areas that I would cut and how much I would cut those.

I am not an expert on Federal spending. I am willing to help look at areas and analyze and tell you what I would like to see as a citizen, and I think the voters are out there saying what they would like to see, and I think we need to listen, but I don't have particular programs that I would recommend cutting.

Mr. COYNE. OK.

Mr. WILLETT. But I think it could be analyzed and I think that is your job and I think you will do a good job in the next several months looking at that particular spending cut area.

Mr. COYNE. Thank you.

Ms. Kellogg, you indicated that you think, in response to Mr. Ramstad, that 2 years is a sufficient period for people to be on welfare and after that they ought to be off. I was just wondering what would happen to those people after 2 years? What do you think would happen if we just cut them off at the end of 2 years?

Ms. KELLOGG. I don't think that we just cut them off at the end of 2 years. I think what has presently started and what hopefully will come will be continuing education, skills training, in a 2-year period. A person would be able to start fending for themselves. So it is not just cutting you off with no skills, no education. It is a continuation of some of the jobs training education programs that are going on now, but they need to be a lot more practical, and if they are a lot more practical then people understand and you do some self-esteem building and some motivating and some reality therapy, then people tend to get their acts pretty well together.

Let me just tell you this, during the time I was working with the welfare mothers when I had a contract—and I never give them up because I work with them all the time, now they are my friends, too—one of the things that I asked them, 1 day I walked into the classroom and I said, if welfare was cut—if welfare were cut off today, that was Friday, what would you do Monday? I had everyone raise their hands and say they would get a job.

Now what does that tell me and what does that tell you?

Mr. COYNE. Well, from my experience we have college graduates walking all over this country that can't find employment today, and to the extent that we are unable to train people in a 2-year period, I just don't think that we ought to be in the position of knocking people off welfare if after the 2 years for no reason of their own, no cause of their own they can't find employment.

But I guess that is not what you are suggesting. You are not suggesting that if at the end of 2 years a welfare recipient can't find employment we ought to cut them off the welfare rolls, are you?

Ms. KELLOGG. I am implying that I asked my class members, if you were cut off of welfare today what would you do Monday morning and they said, I would get a job. So I can only say I am a firm believer that we don't make decisions, certain decisions for people. People have to—there are certain responsibilities that we as human beings have for survival. We have more survival instincts than we give people credit for. People do have survival instincts.

Mr. COYNE. Certainly that ought to be the goal of welfare reform—to train people and get them on the work rolls, but, as you know, the health care reform plan that failed last year didn't lend itself to doing that for welfare recipients. In other words, if they have obligations and they need to provide health care for their families, it is very difficult for them to leave if they don't have employment.

Thank you.

Chairman ARCHER. Mr. Zimmer will inquire.

Mr. ZIMMER. Mrs. Semler, Mr. Stark began his testimony by saying that he was interested in the financial wherewithal of all of our witnesses. Could I ask without your having to be more specific than you would like whether you and your husband have a large portfolio of stocks, bonds, and other capital investments?

Mrs. BARBARA SEMLER. I will defer to my husband on that. He takes care of those matters.

Mr. PHILIP SEMLER. Sir, I don't know what you consider a large portion. Yes, we do have some stocks and we—hopefully they will pay back with a good return. As to large amount, I don't think it is.

Mr. ZIMMER. Do you get much income from those investments?

Mr. PHILIP SEMLER. Right now because of our both working and with what we get from Social Security and being prudent, we leave it in to reinvest.

Mr. ZIMMER. The reason I raise this issue is because of what I consider an anomaly in the earnings test and that is that the— earnings that you make from your own employment are subject to the earnings test, but dividends, interest, and other income that Mr. Stark would call unearned are free from that test.

Do you see any justice in a situation where someone can sit back, not work at all and clip coupons and have hundreds of thousands of dollars of income not subject to the earnings test while somebody who is really struggling and scraping has to pay up above the very nominal limit on earnings?

Mr. PHILIP SEMLER. I try—in all honesty, I try to balance the people who sit back and clip out coupons, if they by their own initiative, so-called work habits and everything else, obtain that kind of wealth, I admire them. I sometimes have a little trouble if it was inherited and they didn't really have to do anything to get that wealth.

How much should that be taxed? I don't know, I will be honest with you.

Mr. ZIMMER. Do you think it should be on a preferred basis compared to earned income as it currently is?

Mr. PHILIP SEMLER. I am not sure I understand the question.

Mr. ZIMMER. OK. Currently dividends, interest, and other such forms of income are not counted toward establishing the fact that you have earned a sufficient amount to start having to give back some of your Social Security. But from the very first dollar of your wages that you earn, you start reaching that threshold at which you have to start giving back your Social Security.

Do you see any logical reason for treating the two forms of income differently?

Mr. PHILIP SEMLER. I am not sure, sir. I will be honest with you. I really haven't given it much thought as far as that. I would hope that—I would hope that you don't still keep taxing one and now add tax to the other. Let's put it that way. I think some study ought to be given to that, maybe, that maybe some fair tax, and again if the money is used right, and used in good intentions and everything in our government, I don't think any of us begrudge paying taxes to have the kind of government and the way we live and everything else. I really don't. I think we are very proud of that.

Mr. ZIMMER. Mr. Willett, you had something you wanted to say?

Mr. WILLETT. If I may offer a different perspective. This past year I haven't able to contribute to any type of retirement savings for myself out of the income I earn, and I think we are looking at the problem from the end rather than the beginning. And in order to qualify for Social Security benefits you have to have had earned income during your life and contributed into the program.

I look at it if I were able to access the funds that are currently—that I am currently paying to the U.S. Government for Social Security that—or the Social Security Administration on my behalf, if I had those and were able to invest them, we wouldn't have a problem of an income test at the end of whether it is private funds that you have been able to save for retirement or whether it is earned income when you retire and take a second job.

I think the issue really is, you know, what is the purpose of the tax from the beginning and are we using it for what it should be and are these funds that we are setting aside that we are taking away, maybe some day I hope I never have to draw on Social Security, and I would like to not and maybe not have to go through the income test, and I would like to offer it to other people who may have more of a need, if that is the case.

But I am still young. I don't know what is going to happen in the next 30 years before I do retire. I would like to know that if I am putting that in that I have some security, that it is going to be there, and if I am able to save some other things, I don't want the money that I could have had and saved for my own retirement taken away from me because I have been able to be successful or fortunate enough to have some other assets that I may be able to rely on.

Mr. ZIMMER. I know my time is up. I would like the record to reflect I am not urging that unearned income be subject to the limit. I am pointing out the disparity of the treatment between earned income and unearned income. Thank you.

Chairman ARCHER. Ms. Dunn will inquire.

Ms. DUNN. Thank you, Mr. Chairman.

Mr. Willett, I would like to ask you a couple of questions having to do with small business. I am especially interested in the inheritance tax and I come from a district in Washington State where almost all the businesses are very small businesses or small timber farms, small farms, that sort of thing, and the inheritance tax becomes very important at the death of the patriarch and the turning over to the family of that business.

I am wondering—as you have seen in our proposal in the Contract, we would lift the lid from $600,000 to $750,000 that would be exempt. I am wondering if that even makes a difference.

What is your thought on that inheritance tax issue?

Mr. WILLETT. Well, two things. I think it is proposed to be indexed for inflation, the exemption, the exclusion, the $750,000, but I don't know if it makes up from the time of the $600,000 to now $750,000 whether that $150,000 is actually what inflation would have adjusted it. I haven't studied that but I would think that it is not enough.

For small businesses, I think there should be an exclusion from the estate tax. My understanding is it is not a large part of Federal Government revenue in the first place. And second, the time and the distractions that small business owners have to go through to do some estate planning and then on top of that, as I was explaining to Mr. Hancock, they have got the problem of paying the tax after the death and then they are jeopardizing their stability to maintain their business and keep the employment of the people that are with them. And we wonder why there is a 7 percent success rate beyond the second generation. Maybe the estate tax has something to do with that.

I think we need to analyze that. I also think we should look at an exclusion for small businesses based on an asset size, employee size, kind of a three-prong test: Asset size, employee size, and gross revenue. And if they meet two of the three requirements, exclude them from the provisions of the Income Tax Code section.

Ms. DUNN. Good suggestions. And moving to the capital gains tax, I was interested in your comments how would you see our structuring a capital gains tax that would make it helpful to small business?

Mr. WILLETT. Well, currently in the Tax Code you can have a 50-percent exclusion of capital gains if you hold an investment that was originally funded for under $50 million with a whole bunch of exclusions, which kind of really narrows down the type of investment that would qualify for 5 years or more.

I think long-term investment is good. I think it should be encouraged but also I don't think that attaching a whole bunch of regulations to it and qualifications will help small business because it will be hard for a lot of them to even qualify.

Now, if this committee is able to act on a 50-percent reduction in capital gains, then small business won't have the current favorable treatment that they are supposed to have under the current Tax Code. If that is the case, I would ask this committee to consider a total exclusion for small business on capital gains held for 5 years and lower the limit instead of $50 million of initial capitalization to somewhere closer to $10 million, take away a lot of these exclusions which include my clients who are on the main street of America starting businesses with nothing and risking everything they have to start a career and create their own stability in life.

Ms. DUNN. Thank you for that.

Mr. and Mrs. Semler, I enjoyed your testimony a lot and I like your suggestion of lifting the earnings limit completely. I am told over the first 5 years that would cost the Federal Government $5 billion but after 5 years it would be a wash, and I see so many benefits to that I think it is well worth our exploring.

There is one complaint that comes often from people who oppose lifting the earnings limit and that is that seniors are taking jobs away from younger people in the work force.

Have you run into that as a problem among your friends?

Mr. PHILIP SEMLER. I really haven't per se. I think there are a lot of jobs out there that the older people are fitted to do that young people either don't want or could not be capable of. Maybe in the years from now they would be.

I just feel that we do have as older people with experience and knowledge and everything, and as my wife pointed out, being some role models to people, that we are able to work. We don't want to sit on the porch in a rocking chair. And we enjoy life and we enjoy this country and hope we can add to it for many years to come.

Mrs. BARBARA SEMLER. May I say that in my field of at this point substitute teaching, we are desperately in need of good substitutes who can deal with the young people, and if we don't have experienced teachers in there coming in as a substitute, it is chaos. And if you can encourage older people to substitute in these classes, you will not have it all fall apart while the teacher is gone.

These are the people we need but if they say—well, our insurance man the other day said his father had decided not to substitute because he was going to have to pay back money after he earned a certain amount and he said, I am just not going to do it. Male teacher. That is what we need, are the males and the expert females. We need them all.

Ms. DUNN. You make very good points. Thank you. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Levin.

Mr. LEVIN. Thank you, Mr. Chairman, and like my colleagues I enjoyed your testimony.

Let me just ask Mr. and Mrs. Semler, this issue that kind of underlies some of the discussion about the earnings test, the average income for people over 65 is about $13,000 and about half of the cost of the proposal to raise it would go to families with an income over $55,000.

Do you think that is something we ought to take into account? Mr. Hancock, I don't think he was recommending it, but he talked about some proposals to means test Social Security or Medicare, which are indeed very controversial, but do you think it is relevant that half of the costs would go to families with incomes over $55,000?

Mr. PHILIP SEMLER. I am sorry, sir. I didn't quite understand you.

Mr. LEVIN. The proposals that are before us to change the earnings limit, about half of that would go to families that have an income over $55,000. In other words, people——

Mr. PHILIP SEMLER. In other words, if we raise the limit——

Mr. LEVIN. Right, right, right. I mean is that relevant at all? Should we take that into account?

Mr. PHILIP SEMLER. If I was in that bracket, I would probably say very definitely, let it go, that we should enjoy it, too. And I am just saying that in all fairness, by raising the limit and allowing people to work—I read an article here not too long ago about a bunch of doctors down here, I think in the Carolinas, that were doing all this work for nothing. I would hope they would do it again, but let's say we want to try to get doctors back into the work force. We well know that $50,000 to a doctor in many cases is not that much so we might not entice these doctors or high-paid professionals to come back into the work force. I just feel that they say, how much money it is going to cost by raising this limit, and what Mr. Bunning said that you had somebody testify from the Social Security—the head of it said let's raise it $200 a year. To me, that is ridiculous.

Mr. LEVIN. That isn't admittedly much of a raise. The $7 billion cost takes into account the amount of additional income tax that would be received. I just think that we ought to take a look at all these factors when we do something. And I don't know if you agree with that.

Let me ask Ms. Kellogg, you say in your testimony many African-Americans migrated to northern cities from the South just to find that good government job. Maybe the experience in Michigan was very different from other States.

Do you have any idea how many African-Americans migrated from the South over the last 50 years and went into public employment?

Ms. KELLOGG. Do I have any idea of the number?

Mr. LEVIN. Yes. What percentage of the African-Americans who migrated from the South went into the public sector? Do you have any idea?

Ms. KELLOGG. I have no idea, but I would say, just from what I know, basically a lot of them. I would say to a large degree. Over the past 50 years.

Mr. LEVIN. Like 50 percent, do you think?

Ms. KELLOGG. Or more, or less; 40, 50, 60. I have—really I have no idea. I just know a lot of people when I was growing up——

Mr. LEVIN. Look, I don't know either, but I think we want to avoid stereotyping, and I am going to try to get that fact and send it to you. My guess is that the number of African-Americans who came from the South who went into government jobs was far less than 50 or 40 percent.

Ms. KELLOGG. I don't think I was concentrating so much on the number as to make another point.

Mr. LEVIN. Which is?

Ms. KELLOGG. It was—a point that I was making was the relationship between dependency, welfare dependency and government dependency.

Mr. LEVIN. But if a fraction of what you say percentagewise of those who immigrated from the South went into the public sector, a fraction, then it would have something to say with your theory. I mean, in most—I think most of the migration from the South involved people who went into industrial jobs and to some extent service jobs unrelated to government service.

Ms. KELLOGG. I would have to say as I grew up I remember what I heard, and I remember until this day what I hear, and in my community——

Mr. LEVIN. All right. I will try to have that fact obtained. If you don't mind, I will send it to you.

Ms. KELLOGG. I don't mind, but as I said, I was not concentrating on percentages.

Chairman ARCHER. The gentleman's time has expired.

Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. Willett, we appreciate you being here today and testifying on behalf of yourself as a small businessperson, also representing your clients who are many other small businesspeople or maybe even large business. But you and your clients do the same thing, that is, you invest, you take a risk, you take a chance and you create jobs, jobs that provide income for a lot of middle-income families, I am sure, and a lot of low-income families and jobs that would be beneficial to a lot of welfare recipients.

Mr. and Mrs. Semler, we appreciate your comments. It is very touching about the fact that you lost your job at the age of 58 and then the stress of trying to find additional work. I am glad things worked out.

Just a couple of days ago, Mr. Bunning mentioned, we had a Subcommittee on Social Security hearing with the Administrator from the Social Security Administration here, and, again, we discussed the cost to the government should we increase the earnings limit. Ms. Chater did finally agree that this would not be a loss of Social Security trust funds, funds that are collected from taxes that are levied on people who work, but the loss would actually come from the loss of penalties that are assessed on people like you who are working.

I appreciate the fact that you want to continue to work and that there are several hundred thousand of you who also want to work. I appreciate the fact that when you do work and you draw a paycheck and you have an income on which you pay Social Security taxes, you are paying Medicare tax, you are paying unemployment, your employer is paying unemployment, you are paying an income tax, you are paying a State tax, you are paying a sales and use tax, you are just paying plenty of tax, so we are deriving income from you at all levels and all areas of government.

Ms. Kellogg, I am very moved by your statement. I plan to share your statement with a number of people in the Third District of Georgia. I agree that the Contract With America is here to restore States' rights. It is also to free people from the slavery of Federalism, which I think is long overdue.

I agree with you that welfare is driving fathers from homes. Mr. Gibbons' comment is well taken that here in the Congress it was addressed early on. Maybe we can ensure through block grants down to the State governments that that provision will be adhered to and we will stop driving fathers from homes.

Jobs are the answer to a lot of those who are on welfare. But jobs come from people like you, a small businessperson, they come from Mr. Willett, a small businessperson, and many millions of small businesspeople and people across this country who are willing to take a risk and to invest.

The only risk that a lot of Members of Congress take is when they put that voting card in that slot and punch the button. They are risking their rear back home. Every time a provision is mentioned in this Chamber or this Congress that will encourage private-sector investments it is criticized time and time again as being merely incentives for fat cat, greedy people trying to make more. In essence, creating private-sector investment opportunities will create jobs for many others.

We do need to drive up the stake on welfare. We need to set a point out in the future that this is what it is going to be, this is how it is going to be, you need to get yourself prepared so you can get off of welfare.

I appreciate the job you do. I appreciate the business you are in, and I appreciate the fact that your funds are actually derived from clients who are distressed because of government interference. Thank you.

Ms. KELLOGG. Thank you.

Chairman ARCHER. Dr. McDermott.

Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

Mr. Willett, in your testimony I believe I heard that, and I will paraphrase you, you indicated that the neutral cost recovery system in one of the tax bills pending before the committee is skewed to large corporations. You followed up indicating we should look at a higher expense figure for small business.

Is that accurate?

Mr. WILLETT. That is correct.

Mr. KLECZKA. What I would like to do is get your thoughts on this thing we call neutral cost recovery. It seems if you use an example of a piece of machine with a life expectancy of 10 years and depreciable life of 10 years, if in fact you depreciate that, plus the additional inflation that is going to be provided for, plus a factor of some 3.5 percent, which is to reflect your costs of losing that as an investment over a period of 10 years on a piece of equipment, a corporation could actually depreciate or deduct more than the actual cost of the item, of the asset.

Could you respond to that?

Mr. WILLETT. Actually, the concept is not so much a principle as it is a good concept. I mean, I have actually taken these numbers and run a test, and I looked at my office building and I will recover—under current tax law, I will recover 34 percent of my original investment by the year 2035, taking into account the effects of inflation.

Mr. KLECZKA. That is because of the long period for a building when——

Mr. WILLETT. The long——

Mr. KLECZKA. But use another example, like the piece of machinery with a 10-year depreciable——

Mr. WILLETT. Most of my clients I would prefer address it as 5 years because most of my clients buy 5-year property. But in the case of 5-year property, still you lose because of the effects of inflation. However, it is still marginal, probably closer to 87 to 81—somewhere between 81 and 87 percent because of effects of inflation over a 5-year period, but they are going to pay for that asset in probably 1 or 2 years. My proposal was to even shorten that depreciation more.

Mr. KLECZKA. Give me the rationale for a corporation being able to deduct more than the actual cost. That is compounded if the corporation borrowed to buy the piece of equipment and took advantage of the interest business expense.

Mr. WILLETT. But the interest is actual cash that they are paying, so the effect is the dollars that they invested today are either cash or moneys that they borrowed, and if they invest that cash today, sure they should be entitled to—I think they should be entitled to a greater deduction than what they actually paid given the effects of inflation, because we are in a cash flow economy. You talk to any investor, you talk to any Wall Street analyst, you talk to any business owner, and what they run their business on is cash flow.

So when the effects of inflation take away the value of your dollars and you are not able to get the benefit, you are paying higher taxes and taking more costs in the form of taxes because you are not able to take the real, true cost to yourself as a deduction for your investment and that investment probably created a job.

Mr. KLECZKA. OK. That might be true for inflation but to add on an additional 3.5-percent kicker, as I call it, I think escapes some logic.

Mr. WILLETT. I think you are right, it may well be. I don't know. But my question—my recommendation was that we shorten the depreciation schedule closer to the financing so that it more matches cash flow. Then you don't have the problem of indexing and adding kickers to it. If it is closer to cash flow, you don't have the problem, and that is where when you went from 15 years depreciation on a real estate asset in I believe 1978 to somewhere to 1984, you are able to do that, after that it has gone steadily up, it goes to 29½ years and now it is 40 years. It doesn't make sense. Going 3 years on a computer to 5 years doesn't make sense, especially when the computer is outmoded probably in 1 year.

Mr. KLECZKA. I think the proposal we will be looking at and marking up in the committee will actually elongate those periods at the onset because of the revenue loss that would occur if you shorten, as you indicate.

Let me ask a quick question to Ms. Kellogg. We had a lot of the discussion yesterday before the committee on the welfare proposal, and one of the items that disturbed some of the members of the committee was the fact that for a teenage mother, she would automatically lose any welfare benefit and those dollars would be given to the States in a block grant wherein the State can form group homes and pay for orphanages and things of that nature.

And my concern was for the teenage mother. I think what we should try to provide is that, one, she stay in the family and, two, finish school. And under the proposal we are looking at, that probably won't occur.

Would you be supportive of continuing some payment for the child, not the teenage mother, but the child, to encourage that teenage mother to stay home and finish school versus giving it to the State and having that mother and child put into a group home?

Ms. KELLOGG. I would support that teenage mothers should stay home with their parents.

Mr. KLECZKA. OK.

Ms. KELLOGG. And I certainly do not think they should get benefits because I think that encourages them to be, from the South where I come from, "grown before they are ready," and they certainly are not ready to parent. So I certainly do not support them being on their own parenting because I am a socialworker, a licensed certified socialworker, MSW, and of course I have seen—I am 51 years old, so I have worked for a long time now, but I have seen a lot and some of the things I have seen, we do a lot more damage to children. We do not want to encourage that.

Mr. KLECZKA. A teenage mother has no income so it——

Chairman ARCHER. The gentleman's time has expired.

Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

Mr. Willett, as you know, the bulk of the new jobs that are created in the economy are created in small business.

I was wondering from your experience could you comment on the likely impact on the survival rate of small business and particularly small manufacturers from passage of a more liberal approach to a cost recovery like envisioned in the Contract bill, and also comment on the likely impact on small business and small manufacturers of increasing, as you suggest, the section 179 expense election to, say, $100,000.

Mr. WILLETT. On the first question, as far as the neutral cost recovery issue that you are addressing right now, I think that manufacturers, obviously small manufacturers will have the greater chance of survival because they will get a greater deduction which more closely reflects the economic reality that they are buying an asset that may have a 15-year life, that they are able to take that depreciation, and the money they are investing today, they are still able to get the value of those dollars in the future rather than some percentage somewhere, 60 or 50 percent of what that investment really was.

Mr. ENGLISH. I know this is a great concern in my area because we have a lot of particularly small manufacturers who are internationally competitive who are constantly having to make major capital investments, and it is extremely difficult for them to do that, and I think you note in your testimony that this is a very broad-based concern in small business.

Mr. WILLETT. I have some clients who to stay involved they sell their product in Australia, in Russia, and they are a manufacturer. They sell all over the United States, Canada, and they invest every year in quite a bit of equipment and they invest cash because they don't believe in borrowing money, and I think the section 179 expense election by increasing that up to $100,000 will more closely reflect reality for them.

They are investing their hard-earned money this year. Why should they pay tax on it when they are creating jobs and investing for the future and improving their competitive edge and maintaining their business in a very competitive environment?

Mr. ENGLISH. Thank you, Mr. Willett.

Ms. Kellogg, Mr. and Mrs. Semler, I very much appreciate your commentary and your contribution in this hearing. I know we have adduced testimony in other hearings already this week, including before the Social Security Subcommittee where we learned that working seniors face extremely high effective tax rates.

We have also heard and will be hearing tomorrow in greater detail in another hearing that the working poor face I believe over a 70 percent effective tax rate. In view of some of the eloquent statements that have been made by members in the hearing today about the equity implications of the Contract, I wonder if you would comment on in your view how equitable it is that these groups, working poor and working seniors, are facing a higher real tax rate in this system than millionaires?

Ms. Kellogg, would you like to comment on that?

Ms. KELLOGG. Well, I don't think I really would. Thank you.

Mr. ENGLISH. Very good. For the Semlers, how does it feel to you to be facing a higher real tax rate than millionaires?

Mr. PHILIP SEMLER. I don't like it. I really feel it is unjust and I don't think it is necessary that we pay this tax in a sense because I think it loses its effect, and I have talked to some people off the record from the Social Security office who have commented to me, saying that it takes more of their time and the money involved in actually doing the collecting or supervising of getting this money back from the senior citizens than it is really worth to really collect it.

No, I don't like to be in the highest tax bracket and I think it discourages a lot of other people who have commented before. I just tell you I am not going to get into it. When I reach the limit, I just wait until next year or never get into it to begin with, and I think we have discouraged a lot of good people.

Mr. ENGLISH. Thank you very much. I think your comments reflect on the subject of the real equity issues that this panel has to address.

Thank you very much, Mr. Chairman.

Chairman ARCHER. Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman.

As was stated earlier, approximately half of the savings if we raise the earnings limitation will go to people who make over $55,000 a year. I say, great. That means half of the savings go to people who make under $55,000 a year. So I think that the problem that we have and with a lot of the testimony before this committee is that we look at our economy as a zero sum game. We look at those who want to get their share of the pie instead of looking how can we make this pie larger. And we get into this class warfare where we preach young against old, we preach rich against poor, certain ethnic groups against other ethnic groups, and I think that is a large mistake that we make in our society and that it can be even dangerous, especially when times get tough.

I think that we need to look as a body at proposals that will benefit all classes of people and, Mr. Willett, I would like you to comment on capital gains and whatever other proposals that you commented on and comment how those proposals can reach across class, whether it is income lines or whatever it is, how those can benefit all segments of our society.

Mr. WILLETT. I think all too often on capital gains, it is viewed as a tax break for the rich. My feeling is and from practical experience I have a client who left employment, had a very good salary, left employment, wasn't able to accumulate much when he was in employment and decided to start a business. For 2 years he was the only employee of this business and the next 5 years there were two employees of the business. He ran into some tax trouble, came and talked to me, I helped him out.

Today, his company is owned by one of the large multinational international companies that is traded on the New York exchange. They have a 30-percent interest in his company. If you were to look at his personal net worth today compared to 7 years ago, he is worth a lot more. He employs 150 people who wouldn't otherwise have jobs and he has come up with a new technology and a new way and a new application in the 3–D animation area. So I think it reaches across classes. He is employing people that are graduated from school now that otherwise would have difficulty finding employment. He has also created a whole new arena of potential job opportunities because he has pioneered a new area in data exchange.

Mr. ENSIGN. Thank you, Mr. Willett.

Mr. Semler, and Mrs. Semler, I appreciate your comments very much because I have been in the private sector my entire life and employed many seniors at the last job that I held, and the constant comment to me was, geez, I can't take any more hours right now because I will start getting into penalties.

It was very disheartening to me at that time. Obviously, I don't think that anybody that thinks that making up to $30,000 a year is a lot of money, especially if you live in any type of an urban district in this country of ours, and so I appreciate your comments today showing that we need to reward people as they get into their years where we want them to be more productive.

People are healthier; they are living longer. If we are going to have a society that cares about people as they get older and want to be more productive—I don't think a lot of people like to retire. A lot of people love working, and I appreciate your comments very much today.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman, and I want to thank all the panelists who are here today and thank you for your testimony. It has been very helpful to us.

Mr. and Mrs. Semler, I wanted to just comment on your testimony because I thought it was very good and very compelling. We, as Chairman Bunning had mentioned, had a hearing earlier this week on this subject in his subcommittee, the Social Security Subcommittee. And I think the conclusion there, and perhaps the conclusion on this committee, would be that we are all trying to work together to do the right thing for working seniors.

As we look at exactly what that is, we have to be aware of the fact that we have a responsibility here not only to the present recipients but to those people who are now working and paying into the system who intend to be recipients in the future.

And so that we have to maintain the integrity of this trust fund. What that means is that when it is said to us that over a 5-year period a provision like this will cost, after taking into account additional taxes that will be paid, about $7 billion over a 5-year period, we have to look at that and accept responsibility to try to determine how we maintain the integrity of the fund. Certainly Chairman Bunning in the committee meeting, expressed his interest and the necessity of doing that, and witnesses there, the AARP witnesses and so forth, said that they wanted to work to that end.

I want to ask you how you think we ought to maintain the fund integrity because I think that is our job, how to determine how we should best do that. But I do want to say that we all want to do the right thing for working seniors, and your testimony has certainly helped us to understand the issue better.

Mr. Willett, you were talking about section 179 and this is an issue that certainly I have a great interest in. In 1993, we increased the amount from $10,000 to $25,000 in this committee. Subsequently, it changed and it became then not $10,000 but $17,500.

I think for people who have small businesses, a number of people who are my constituents had commented that this was helpful to them to the extent that the limit was increased. And I think it would be helpful if you might comment to us, based on that increase, which at that time was a 75-percent increase, has that been helpful to your clients and others you have spoken to, and to what extent has that proven to be a good move?

Mr. WILLETT. I think it has been helpful. Section 179, though, I don't think is just intended for small business. I think it is intended for all businesses and raising it 75 percent to $17,500 has made a difference for some people, but if you look at the numbers I have submitted in my testimony today, most of my clients were already purchasing in excess of $17,500 before that was passed in 1993. And so all they are doing is getting an additional tax benefit, which is a nice relief.

But to create further investments and to let them make the next decision, I want to buy a larger piece of equipment, I am going to expand my plant or my manufacturing facility, and do I do it or do I not do it, if I am going to get a tax break and I am going to save dollars today, those taxes, the $20,000 or $30,000 I may be paying in taxes or $10,000 or $5,000 that I may save by investing an additional $10, $20, $30, $40, $50, $60,000 than maybe I otherwise would is a good incentive.

I think that is where you are going to hit most small businesses. Startup business, $17,500 was good, but if you are in your second or third year, if you are buying any type of computers nowadays and you have more than two or three around the office, you are spending that to maintain your computers.

Mr. PAYNE. As a small businessman myself who ran a business before I came here, I certainly understand that. But please understand from our perspective one of the responsibilities we have is to ensure that we are reducing the budget deficit, and consequently as we look at the amount of money we can make available for expensing and other reduced taxes, we have to do that in such a way that we don't increase our budget deficit, and that is a constraint we are dealing with.

Mr. WILLETT. I can appreciate that, and I kind of allude in my testimony to the fact that, you know, not being an expert on government spending but maybe it could be an alternative to neutral cost recovery for smaller businesses, because in the first 3 years under neutral cost recovery the small business will actually be hurt.

And if they pass neutral cost recovery, there has got to be something given to the small business so there is going to be money picked up through neutral cost recovery by reducing and stretching out that length of time in the first couple of years. So to offset that effect, you need to have the 179 either coupled with or as a substitute for neutral cost recovery.

Mr. PAYNE. I see my time is up. Thank you very much.

Mrs. JOHNSON OF CONNECTICUT [presiding]. The gentleman's time has expired.

Mr. Nussle.

Mr. NUSSLE. Thank you, Madam Chairman. I really appreciate the practical advice that you have been giving in this panel and I want to continue with that vein.

Ms. Kellogg, you mentioned that if somebody on Friday discovers that the welfare system has been eliminated there is this instant reaction, at least in the people that you have dealt with, that they need to go out and get a job, they recognize that.

Do you think—I mean, is there any variation on that theme? Is it that instinctive, if you will, that somebody knows that now that they lack that dependency in one vein that they know that by Monday they have got to figure out a way to pull themselves up? Because I have to say that there is some concern, and I have to say I share it, that because we have been locked into this system for so long that that reaction may not be automatic in all circumstances.

How wide ranging do you think that reaction is?

Ms. KELLOGG. I can only tell you what I—the question I proposed to my class and the response that I got. As far as going beyond that point, I have not, but when I posed that question to them, they said that they would go out and one person said, well, I would get—she said, I could get a landscaping job until I learned how to do other kinds of things or when I am able to get some training. She said, I would like to work outside; I would go and ask and knock on doors and see if I could cut grass.

So it was an instinctive kind of survival thing, but as I said, I posed a question on, this is Friday and welfare is cut off today, what will you do Monday morning. They said, I will have a job.

Now, that is a little optimistic, too, sometimes, but as I said, she said, I will go cut grass.

Mr. NUSSLE. What happens on Saturday and Sunday? What struggles are they going through and is there a role for government? In other words, between the reaction that they recognize that, look, this is going to end and I have got to go do something about it, I mean what struggle are they going through, what practical struggle?

Ms. KELLOGG. They are going through lots of struggles because they bring a lot of baggage with them. They have learned a lot of behaviors and attitudes that are not conducive to success, so they need a lot of help. They need a lot of practical help as well as some skills training and things of that nature. But I am not at all suggesting that welfare should be just cut off and people not receive the help to become self-sufficient.

Mr. NUSSLE. And I recognize that, but this is a scenario that you are playing through, and the other part of this, and I want to go to Mr. Willett, too, because Monday night when they come back and they find out that they didn't get a job because there may not be jobs available, and they are wondering why and we are wondering why, and to close the loop, and I hear this from a lot of small businesspeople in particular, they say—we can't—what is our incentive to create a job for this type of a person who has just come into the work force who has been locked into dependency, who doesn't necessarily have the work ethic yet, doesn't necessarily have the skills, how do we go about creating that job?

And I guess from a practical standpoint, because this really does close the loop, what can we do in order to help? Because welfare reform, everybody says let's end welfare as we know it, that is fine, but there are some practical problems with this person, whether it is cutting the grass or whatever it might be, how do we make sure that that is available for them on Monday when they go out and look?

Mr. WILLETT. In addition to just the person who may be coming off of welfare, how about the person who just lost a job? Some of those people consider even starting a business, and how nice would it be instead of taking on the risk of already investing everything they have, commit their time, that is their most valuable asset. In addition to that, they are asked to risk and borrow money from a relative because they don't have any source to borrow from a bank and have the prospect of having to pay that back, that is a lot of risk all at once.

What if they were to have the incentive or access to capital where they could have somebody invest in the equity and say, I believe in what you are doing, I believe in your idea and concept, and I think it will be successful and have that capital basically free?

It comes in and the person is willing to do because they have some incentive to make that type of investment to create the jobs because they are not going to be taxed at a high tax rate on a return if the business is successful.

And so the individual that is starting the business is taking a big risk, investing all their time. They don't have capital. Why penalize the person who is going to give the capital to add the stability, take the stress away from the person that is starting that business and allow them to be successful?

Mr. NUSSLE. So this is the loop we have got to close. You can't just eliminate welfare. We have got to work on the opposite side. I think that is right. That is one of the reasons that the Semlers said, because you went through this at 58 years old, if I understand from your testimony you had to start all over from ground zero, and that challenge will be there regardless of whether it is welfare or whether it is losing a job, so that is why this loop has to be closed.

Mrs. JOHNSON OF CONNECTICUT. The gentleman's time has expired.

Mr. Neal of Massachusetts.

Mr. NEAL. Thank you, Madam Chairman. I am hearing I think more opportunity for common ground, even through Mr. Nussle's testimony, than I think many of us assumed on the outset of this debate on the issue of welfare.

And one of the things I would like to ask, Ms. Kellogg, if I could, you did indicate great emphasis on individual responsibility, and I thought the testimony was very instructive this morning in that sense that I think many of us can identify with the arguments that you offered to the committee this morning. But you do say in the next breath that there has got to be training.

Ms. KELLOGG. I beg your pardon?

Mr. NEAL. You do say in the next breath about that individual who says, I will get a job on Monday, that the reality is that she may well not get a job on Monday.

Ms. KELLOGG. What I said on Monday was just I posed a question to a group of welfare recipients that I was working with through a contract I had. And I posed that question to them just to see what their response was. What I gave to you was the response that I got. I am a firm believer that they need training and educational opportunities.

Mr. NEAL. Who provides that training and educational opportunity?

Ms. KELLOGG. Well, I certainly think the funds that are going to go to the States through the block grants to the States or the people——

Mr. NEAL. Do you accept a role for government in that?

Ms. KELLOGG. Absolutely.

Mr. NEAL. OK. Let me ask you this, and maybe you could describe for the committee an issue which I have focused on for a long time and I think it is the most painful part of the welfare debate. It is the out-of-wedlock birth rate in America. And the truth is that a young woman at 14 or 15 years old who has a child, that is the person who stays on welfare for a lifetime. It is not, as Secretary Shalala said yesterday, the overwhelming number of welfare recipients who move into the system and out of the system in a relatively brief period of time. It is, however, that young woman who has that child at 14 or 15 or 16 who stays on the system.

But the debate that we are going to undertake here, and I think again it ought to be a vigorous debate, is going to be over at least paternity establishment in some measure. And many of the clients that you have had, do they readily cooperate with the authorities on the issue of establishing paternity? Are they reluctant?

Ms. KELLOGG. Clients that I have worked with? Now, I have none at this point. And I am not sure if the committee quite understands the role that I have played in this. But I tell——

Mr. NEAL. Let me flip the question. Do you think in the social contract or the contract that has been offered, the Contract With America, do you think that overall welfare reform ought to include a rigid requirement for paternity establishment, child support?

Ms. KELLOGG. Well, I keep hearing that on the news and reading in the newspaper, and the question that keeps coming to my mind is when some of these children are being fathered by 13, 14, 15, 16 year olds, where are they going to get the funds, you know? You can establish paternity but where are they going to get the funds to pay child support?

So we only enslave more because then what are we going to do, put them in jail or are we going to say, by the time you get 21 you are going to owe the State or the Federal Government $250,000? We just blocked them off again. We just enslaved again.

Mr. NEAL. Let me indicate——

Ms. KELLOGG. Who is fathering these children? What age group? I think we need to look at that and do a study to see is it going to be effective, what we are saying now.

Mr. NEAL. Do we let that young man at 14 or 15, does he skate free from any sort of obligation to that child for the rest of his life?

Ms. KELLOGG. I am not saying that. I am saying is it realistic to think just because we establish paternity and go after him for child support, where is he going to get the money to support the child? He has no jobs, no skills, no education. Who are fathering these children? I think we need to look at that; we need to do a study there. We need to see where are they coming from.

Now, if it is a person, a father with an income and education, absolutely. But my thinking is from what I see is a lot of young, 18 and under fathers.

Mr. NEAL. Well, can we not make a constructive argument that if you are old enough to father a child, you certainly have some role in supporting the child?

Ms. KELLOGG. Well, now, that is ideal, but I don't think that is being very realistic with what we are dealing with in today's society.

Mr. NEAL. In the testimony we heard today, if we are not going to try to effectively close the loop, as Mr. Nussle said, how do we go about restraining antisocial behavior?

Ms. KELLOGG. Maybe we can require—if we can require a 14 year old, a 15 year old, a 16 year old to get a job at McDonald's and then we say, we are going to take 50 percent of what you are earning to contribute to this, we can do that kind of thing, but we have to look at what we are dealing with.

Mrs. JOHNSON OF CONNECTICUT. The gentleman's time has expired. Mr. Shaw will inquire.

Mr. SHAW. Thank you, Madam Chairman.

I would like to pursue just a moment the questioning and the line of questioning that my friend from Massachusetts has been following, because I think that is an interesting question, and I know that much of what he is doing, Ms. Kellogg, is outside of your scope of expertise.

But I would just like to throw this in. I think the establishment of paternalism is tremendously important and I think placing the responsibility is tremendously important. I think you are correct that you can't get blood out of a turnip, but these young men grow up, too, and I think there must be a sense of responsibility in themselves. This may in itself be a deterrent from them getting these young girls pregnant.

We all know that there are many of these fellows that are having five and six kids with that many women, and it is wrong, and they have no sense of responsibility because they have never been called upon, and I think that is a very important facet in welfare reform.

It is not included in the Republican bill at this particular point. However, I said yesterday and I will say again that we are going to have a bill out very shortly. In fact, I would say we would have it out there before we have welfare reform completed, and we are going to schedule hearings on it, and it is an issue about which there is great bipartisan support, and we can push a bill through very, very quickly, and I think male accountability here is desperately missing as part of the formula.

Ms. KELLOGG. When it comes down to accountability or declaring that I am the father of that child, there is no lacking of that.

Mr. SHAW. As a matter of fact, a lot of them turn up at the hospital handing out cigars.

Ms. KELLOGG. Absolutely. There is no lacking of that. Much of what I am saying is, I think—and to chase that, I think, is important, but I also think you are almost chasing—beating a dead horse to death, because what we are looking at, many of these young men are dead that have fathered children.

What I discovered and my expertise is quite broad, what I discovered, I have discovered that many of the same fathers have fathered two or three children with the same age group girls at the same time. I don't know if I made myself clear. I know what I am saying, but did you understand what I am saying?

Mr. SHAW. I understand what you are saying.

Ms. KELLOGG. Many of them are dead and they are being shot and killed daily in the streets. So I am saying how much we need to know, first of all, as far as the teenage—the teenage girls are not going out there and mating with men who are mature, educated, and skilled. I am thinking that oftentimes it is coming from that 18 year old and under, unskilled, and the only thing we have there is a another welfare population of people who need help.

Mr. SHAW. Let me go to another area in which you were very eloquent, and I would like to pursue that because with welfare reform we are obviously going to need a tremendous attitude change among people in government, I am talking now about the bureaucrats who are counseling these young people, instead of continuously just telling them how much they can get, they should tell them what they have got to do. You need a motivational type of person rather than just a bureaucrat who is handing out fliers with information on where they can get this service and that service.

What do you see as far as the role of the counselor in the new welfare reform package with respect to how that person would proceed in dealing particularly with these young people who have never really even had a person in the house, no one really to look up to to show them how they should model themselves?

Ms. KELLOGG. An empowerment role. It is no longer—it is an empowerment role. I find if people are motivated, if their self-esteem is good, then they put forth the initiative. So what if I have to go to night school and hold a job during the day and take care of the babies? If I am motivated from within—I am a businesswoman. I have been in business 12 years. I raised two sons. I never went on welfare. I could have. There were times, 12 years of blood, sweat, and tears, and I will still get into it at this time.

So the initiative, the motivation, the self-esteem is that I have a mission and purpose in life, that there is a place for me in life, that I am somebody, that I can make a contribution. This is the kind of thing, because we spend too much time on trying to tell people where if you get this, you can get there. We need to motivate. The counselor's role is to empower them to go out and realize that they can develop to their fullest potential.

Mr. SHAW. And it is your testimony that the present welfare system is destroying the potential for motivation that is within these people?

Ms. KELLOGG. Yes. It creates dependency.

Mr. SHAW. Thank you.

Mrs. JOHNSON OF CONNECTICUT. The gentleman, Mr. Rangel, is recognized to inquire.

Mr. RANGEL. Thank you, Madam Chair.

Ms. Kellogg, could you give me based on your experience a profile of this teenager? I would kind of think——

Ms. KELLOGG. What teenager?

Mr. RANGEL [continuing]. That she is irresponsible, that she is a high school dropout, that she probably comes from a family that has had no male in the house, that she should be second, third, or fourth generation welfare, that she comes from a community with very high unemployment, that one of the things that her problem is that probably you never face is that she doesn't really find a stigma to getting pregnant, she doesn't really have a hope that there is some fellow in the community that she would fall in love with and marry and raise a family because, as you pointed out, he is shooting somebody or shooting up drugs.

This person has very little self-esteem, but more importantly, very little hope that her life is going to be a part of the American dream and lacks that motivation to try to do any better because she doesn't think that she can. Is that generally——

Ms. KELLOGG. Yes. And you know, going back to the question that Mr. Shaw asked, what should the role of the counselor be? The role of a counselor should be to walk into that person, look that person in the eyes, and say, you might not know your potential, but I do, so get up.

Mr. RANGEL. My point is to keep them away from counselors and see what they do.

Now, the fellow that is in this block, as you said, 13, 14, 15, irresponsible, no job, no skills, and no hope to make a contribution, and I would check out those older people that hang around with a couple of dollars on the corner, too, with the longer cars and the boom boxes and that thing, but generally speaking, this kid comes from the same environment, doesn't have any training at all, really doesn't care if he gets arrested, obviously they do time and they go right back to jail, and it is this person that doesn't mind shooting up a block knowing that someone will come looking for him, so that even the question of life isn't that important to him. Talk about lack of self-esteem.

Would you not say in this same community this is what the teenage mother is faced with?

Ms. KELLOGG. The same profile that you just gave of the teenage mother, to a large degree, too, somewhat. Somewhat.

Mr. RANGEL. And in all probability his mother was a teenage mother.

Ms. KELLOGG. One of the things I find about the teenage mother they do "love their children." So when I work with them, I use that.

Mr. RANGEL. No, no, I am trying to see——

Ms. KELLOGG. Because sometimes——

Mr. RANGEL. When you were working with them, you had a government contract. I am trying to get government out of this. I want to see whether we can have these kids inspired where they don't need us in their environment, because in this community, and you stop me if I am wrong, you got the highest unemployment, probably double the national average. You got to have the highest high school dropout, the highest drug involvement, the highest criminal activity, the highest AIDS, the highest tuberculosis, the highest number of homeless, in other words, if you didn't get special counseling, you are almost destined to be despondent and unmotivated because you don't see where when they talk about America, they don't know you, they don't know me, they don't know anyone in the community, and so they say, you don't mean me when you talk about high-tech, high-paying jobs. So the whole community here is lacking something, isn't it?

Ms. KELLOGG. Well, what I am saying is where did we get this community from? We get the community partly from the welfare system. We have been talking welfare for over 40 years, so we have had plenty of time to create this, because mothers—as a single mother, I divorced my husband when my twin sons were 5½. They are now 24 years old. Now, that——

Mr. RANGEL. I am trying to——

Ms. KELLOGG. What I am saying is I know a woman cannot raise a child on her own, so we have created these communities and partly because of welfare.

Mr. RANGEL. Didn't you agree that government has some role in providing the education and the job training?

Ms. KELLOGG. Absolutely, yes.

Mr. RANGEL. That is what I am trying to say, Ms. Kellogg. I am trying to say that don't you agree when a youngster is motivated toward getting a job, that that job in and of itself brings a sense of pride and a sense that they want to do better, just that job?

Ms. KELLOGG. Absolutely.

Mr. RANGEL. Just working, just getting that check. So if we could tie up the educational system with a job, not just a diploma, do you believe this would go a long way to motivate that child not to have children, not to try to make children but to improve his or her life?

Ms. KELLOGG. Absolutely.

Mr. RANGEL. And the government must participate in providing that——

Ms. KELLOGG. Absolutely.

Mr. RANGEL. Thank you.

Mrs. JOHNSON OF CONNECTICUT. The gentleman's time has expired.

The gentlelady from Connecticut will inquire.

Mrs. KENNELLY. Thank you, Madam Chairman.

Thank you very much, Ms. Kellogg. We are certainly putting you to the test.

We have been doing studies and we are all very interested in this and, unfortunately, we are finding that often the very young teenager's, and I think you know this, first pregnancy can often be an older man in the community who already has established relationships or isn't there as a partner. I know you say you are not in the business of having clients per se, but you have had an awful lot of experience.

Could you just enlighten us at all as we talk about this? We see the teenage mother is the problem; she hasn't got the skills. Yes, she might try to get a job on Monday. That is youthful optimism. But, there often isn't a job there. Can you help us at all on how to avoid teenage pregnancy? That is really what we are wrestling with.

Ms. KELLOGG. How we would avoid it?

Mrs. KENNELLY. Talk to us about that, what you just told us. Is there any other conversation about how they could have possibly avoided this, to help us?

The key problem here is we have got young women without skills having children that they have trouble supporting and being independent with, and the root cause is pregnancy, teenage pregnancy, which Charlie says has become very acceptable in the community.

Have you, with your years of experience, figured out any way we can help avoid teenage pregnancy?

Ms. KELLOGG. I can tell you, one of the ways that we can help avoid teenage pregnancy is to stop paying cash benefits for teenagers to have babies.

Now, if I, as a teenager, or my daughter or my niece or my friend's daughter, knew that I can have this baby; I don't have to worry about how I am going to support it. When I was growing up, I knew I couldn't have a baby. It would not be tolerated, number one, from the family point of view. But let's go beyond that.

How would I support it? Because, number one, chances are from where I came, I would have been put out. So my common sense says absolutely no, because you don't want to be out there, but we have made it easy because there is no question. So that is one way.

Now that doesn't say we are going to wipe it out, because human nature is human nature. We have had unwed pregnancies—pregnancy out of wedlock since the beginning of time.

Mrs. KENNELLY. Thank you.

Quickly to Mr. Willett, I notice you are in favor of the flat tax, and I know you have been down here and busy, but have you had a chance to look at—yesterday Minority Leader, Mr. Gephardt, came out with a different flat tax that unearned income is, in fact, taxed where with Mr. Armey, the majority leader, unearned income is not taxed.

Would you look at this as a better possibility or in competition or possible support?

Mr. WILLETT. First off, I want to clarify. I don't think my testimony indicates that I am in favor of a flat tax.

Mrs. KENNELLY. Oh, I thought it did.

Mr. WILLETT. No. I haven't had a chance to study Mr. Gephardt's proposal. I am interested in it. I studied somewhat Mr. Armey's proposal on the flat tax concept. As an accountant, I read that my industry is not in favor of it. Personally, I formulated an opinion on it. Anything that would help make it simpler and would reward investment and give incentives for jobs and take away some of the decline of the moral character, because that is part of the problem that we have been discussing here today, you know.

We are too dependent. The welfare system should have been a safety net and not a hammock, and it has become a hammock and that has caused immoral character and now we got a vicious circle. We are trying to say how do we get out of it.

You have got to change the strength of the moral character of the people in our country. That is the problem. We have taken that away. We have given them a hammock to sleep on when they do something that may not be morally correct. Now we have to help them out of the situation. We need to prevent them from getting there.

I have a 6-month-old, a 3-year-old and a 6-year-old son, and I sit here today and I wonder what is going to happen with them, their responsibilities as taxes, will they have a retirement. My father lost his wife when he was in his fifties. He is on Social Security today. It took his desire away to work. He had his own business. He lost his business. He is dependent on Social Security. He needed the safety net. And I went to lunch with him the other day. He told me that he would rather not be on Social Security. He would hope and it was his dream during his life that he wouldn't be dependent on it, but he is.

Sometimes it needs to be there as a safety net but when it becomes our sole goal and becomes the focus of our community because there are programs that we can rely on that take away the consequences of things that we have control over, that we have responsibility for actions that we take, then we have a problem in our country.

And that is the issue that really needs to be resolved, is the moral character of our families, and that will resolve the welfare problem, not all the programs, not all the spending because it is not working. It has created the decline of moral character, in my opinion. And so——

Mrs. KENNELLY. Thank you, Mr. Willett. And I think we all wish we could be and hope we could be independent in life, but I am glad your father has got Social Security and I know if in fact things don't go totally right for you, you have Social Security.

Thank you for your testimony.

Mrs. JOHNSON OF CONNECTICUT. I have two questions I would like to pose. First of all, I would like to thank the panel for their very thoughtful input and their ability to enlarge on their experience and the experience of those they have had contact with over the years. It has been very helpful.

Mr. Willett, two questions. First of all, is expensing more important or neutral cost recovery?

Mr. WILLETT. For small business, expensing is more important.

Mrs. JOHNSON OF CONNECTICUT. Your chart shows that expensing up to $50,000 is very helpful and I appreciate that.

Mr. WILLETT. Thank you.

Mrs. JOHNSON OF CONNECTICUT. Why is it in your testimony that you say your health insurance is $413 a month but without the deductibility it is $688 a month? That is more than a 50-percent increase.

Mr. WILLETT. That is a typo. In my oral testimony I said $578. It is a typographical error. The six and the eight should have been a five and a seven.

Mrs. JOHNSON OF CONNECTICUT. OK. Still that is a very significant increase, and I do want you to know that this committee at least is committed to trying to reinstate the 25 percent retroactively to its expiration date by April 15. Now whether we will be able to get the cooperation of both Chambers and move this through——

Mr. WILLETT. Well, I know a lot of my clients would be appreciative.

Mrs. JOHNSON OF CONNECTICUT. We are working very hard to attain that goal and that thereafter it was certainly part of the Republican health care initiative to move that deductibility up toward 100 percent. We used 100 percent but considering the copayments that everyone has assumed, probably working to a lower percent makes greater sense.

One last question. We have had testimony that the neutral cost recovery provisions in the Contract could open up an exploitation and the steering of capital similar to the shelter law. Do you share that concern?

Mr. WILLETT. I didn't hear the exact testimony. I don't know if they are referring to some type of leasing organizations that acquires assets and then loses them and takes some type of benefit and is able to take some cash benefits from accelerating deductions or keeping deductions higher than cash flow. That—it is conceivable that that would be the case, but I think if we are worried about gaming with the tax laws and that, maybe there is some burden that the tax rates are too high already.

If the tax rates weren't so high, people wouldn't spend so much time trying to shelter that. I think you would avoid the problem by looking at other proposals and other aspects, and I think an income tax rate deduction, and that is why I proposed that today, would eliminate some of what I hear when I come to Washington about gaming with the tax law.

Mrs. JOHNSON OF CONNECTICUT. I thought that was a very good point that you made in your testimony.

Would you reflect on this? The testimony that we received was not specific in terms of what kinds of exploitations they foresaw. But the concern arose from the fact that you would not only be able to write off the cost of the equipment and its inflated value but also the interest on any borrowed funds. So it is a rather rich reward for those needing to invest in capital environment. The thought was that that would lead to different kinds of deductions than are currently made.

Mr. WILLETT. I think if that is the emphasis of the testimony, it may not be totally correct, but currently you can deduct the interest that you pay on the acquisition of capital equipment already, so it is not expanding it beyond that. All it is doing is indexing it, so you are getting real dollars, which is a concept that accountants are trying to do, is get today's 1994 dollars for your investment and still being able to take the benefit of that investment in the year 2035. For example, though those dollars are invested today, if you are actually going for long term, and less match to long term so people have the incentive to investment longer term rather than short term.

We had problems in the seventies and eighties because we were too short-term focused. If we are going to do that, I think neutral cost recovery effectively helps people make a better longer term decision, because as accountants today—I know I sit down with a client and I analyze what is the payback period on this investment, can you recoup the dollars you are investing today within a reasonable period of time and I have to counter the effects of inflation. If we can offset that with a deduction, it would help.

Mrs. JOHNSON OF CONNECTICUT. Given your experience with business, is it as important in terms of revitalizing our economy to provide better incentives for machinery and equipment and preferencing capital investment the way the neutral cost recovery provisions do or is it more important to strengthen expensing to allow much smaller businesses to grow?

Mr. WILLETT. From a small business perspective, I would say it is more important that those companies that don't have access to capital markets as easily as the large companies to get financing where it is a lot more available at a lower rate, because a small business owner starting up with no capital, if he borrows from the bank he is going to pay prime plus 3 or 4 percent, where the Fortune 500s can borrow it at prime, or do an equity offering and pay nothing other than the cost of the offering for that money and maybe potential future dividends, but that is—the small business owner is in a disproportionate situation. He has a higher cost of capital no matter what, and if you were to lower that cost of the capital whether it be through capital gains incentives, whether it be through greater expensing or neutral cost recovery, I think he has greater chance of survival.

They are the ones that become the Fortune 500 companies of tomorrow. And we have seen the decline of a lot of the Nation's largest companies and probably some of the largest capitalized stocks in the New York Stock Exchange have gone through some major restructuring in the last few years.

Mrs. JOHNSON OF CONNECTICUT. Thank you very much, and I thank the panel for their testimony.

Chairman ARCHER. Thank you again very much for spending this time with us and for the excellent input that you have given us. You are excused and the committee will stand in recess for about 5 minutes until the next panel is assembled.

[Brief recess.]

Chairman ARCHER. Would our next witnesses take their seats at the witness table so we can continue with these hearings.

Our next panel is composed of individuals who have extremely excellent credentials, both academically and experiencewise, and we are looking forward to your testimony.

I would like to begin with Michael Novak. He is a theologian, historian, and social concept writer. He has written a great deal about the welfare system and many other subjects and, Mr. Novak, we welcome you to the committee and we would be pleased to hear your testimony. If you can reduce your oral commentaries to 5 minutes and insert the balance of your testimony in writing in the record, we would appreciate that.

STATEMENT OF MICHAEL NOVAK, GEORGE FREDERICK JEWETT CHAIR IN RELIGION AND PUBLIC POLICY, AMERICAN ENTERPRISE INSTITUTE

Mr. NOVAK. Thank you, Mr. Chairman.

It is an honor to be present for the opening debate on the Contract With America. The debate about the items in this Contract may prove to be a major turning point in American life.

When our Founders spoke of the American Revolution, they used the term "revolution" in its ancient sense to mean the Latin word "revolvere," to turn back. To revolve is to turn back to first principles. Also, that is what they meant, to return to the first principle on which the whole revolution and the whole later Constitution were established.

Two-thirds of the country now says that this Nation is on the wrong track so it may be time to turn back to first principles, that is, to the principles of our Founders since that is certainly the right track. And that is the track in the light of which Americans tend to judge whether we are going right or wrong.

As a theologian and longtime seeker for the first principles of the American Republic, I find no better text than one by a former President. The last time I quoted from this text, I warn you, many who heard me thought I was quoting President Reagan but the words actually are those of Thomas Jefferson's first inaugural address, March 4, 1801. I believe you can hear the accents both of the founder of the Democratic Party, Thomas Jefferson, and of Ronald Reagan in the same principles.

In Jefferson's words, "Every difference of opinion is not a difference of principle. We have called by different names brethren of the same principle. We are all Republicans. We are all Federalists." So as our first principles are bipartisan, I hope the debate to come will also be bipartisan and there are good signs that that is the case.

Mr. Chairman, there follow now the words of Thomas Jefferson about the original contract between the people of the United States and their government. This is his statement which he calls the creed of our political faith, the bright constellation of our first principles, and now the rest I will quote from him:

> Let us, then, with courage and confidence,

he said in a moment of cynicism,

> pursue our own Federal and Republican principles, our attachment to union and representative government. Kindly separated by nature and wide ocean from the exterminating havoc of one-quarter of the globe; too high-minded to endure the degradations of the others; possessing a chosen country, with room enough for our descendants to the thousandth and thousandth generation; entertaining a due sense of our equal right to the use of our own faculties, to the acquisitions of our own industry, to honor and confidence from our fellow citizens, resulting not from birth, but from our actions and their sense of them; enlightened by a benign religion, professed, indeed, and practiced in various forms, yet all of them inculcating honesty, truth, temperance, gratitude, and the love of man; acknowledging and adoring an overruling Providence, which by all its dispensations proves that it delights in the happiness of man here and his greater happiness hereafter; with all these blessings, what more is necessary to make us a happy and a prosperous people?
>
> Still one thing more, fellow citizens—a wise and frugal Government, which shall restrain men from injuring one another, shall leave them otherwise free to regulate their own pursuits of industry and improvement, and shall not take from the mouth of labor the bread it has earned. This is the sum of good government, and this is necessary to close the circle of our felicities.

Mr. Chairman, it is no long stretch from these felicitous sentences of Thomas Jefferson to our debate today about the balanced budget amendment, the line item veto, the application of the laws that bind other citizens to the laws that bind this Congress, to welfare reform, and the other items of the new Contract. All of these are small steps toward a more wise and frugal government.

Mr. Chairman, it is not in my power to state better than Thomas Jefferson did the principles on which this Nation was once built. We have wandered far from these principles. We have lost sight of them.

Jefferson had an image of minimal government and a maximum of self-government, of industry, of honesty, and of the citizenry who are free and independent because for what they receive, they make their own contributions. There is a kind of covenant, such as President Clinton spoke of, whereby those who receive from the public good must also contribute to the public good.

If the debate of the next weeks leads this Nation to retrace its steps back to the tracks on which it began, this shall have been a great and historic debate. As Jefferson said: "Should we wander from these principles in moments of error or alarm, let us hasten to retrace our steps and to regain the road which alone leads to peace, liberty and safety."

Thank you, Mr. Chairman.

Chairman ARCHER. Thank you, Mr. Novak.

Our next witness is Dr. Michael Boskin, professor and senior fellow at the Hoover Institute at Stanford University in California and former chairman of the Council of Economic Advisers to the President of the United States.

Dr. Boskin.

STATEMENT OF HON. MICHAEL J. BOSKIN, PH.D., T.M. FRIEDMAN PROFESSOR OF ECONOMICS AND SENIOR FELLOW, HOOVER INSTITUTE, STANFORD UNIVERSITY, STANFORD, CALIF.

Mr. BOSKIN. Chairman Archer, Ranking Member Gibbons, and other distinguished members of the panel, and especially to the new members of the panel I was just introduced to, congratulations on joining the panel. I look forward to working with you, and I appreciate the opportunity to share with you my thoughts on the Contract With America.

The Contract is a commitment to bring to a vote in the House 10 bills, each of which contains several provisions designed to achieve important objectives. Not all of those provisions are within the purview of the committee, but I would just make a few general comments on the general issues in the Contract and then speak briefly on the tax provisions.

The broad basic theme of the Contract With America is that while America is the strongest, freest, and richest major industrial economy in the world, it does confront serious problems and challenges. Important and bold policy reforms are necessary to strengthen the economy and our society more generally.

Most of these reforms have in common the theme that the Federal Government has overreached in a variety of areas and programs and that on balance it is either not achieving the goals of those programs in a cost-effective way, not achieving them at all and/or it is preventing the private sector, families, and businesses from realizing their full potential.

Taxes are too high. The government spends too much and inefficiently. The government borrows too much and in general should not be borrowing except in extreme circumstances. The Federal Government's rules and regulations put far too many restrictions on private activity, imposing large compliance costs and stifling innovation. Too much power has been centralized in Washington and not devolved to the States and localities and America's households.

It is important to understand that while every elected official who has been speaking recently in both parties, and in the executive and legislative branch, has been calling for increased personal responsibility, that the greater accountabilities for Congress called for with the Contract on which a very impressive downpayment was made the first day, I believe is an enormously important item in restoring confidence and trust in a leaner, more efficient, more effective government.

While people have argued items in the Contract and the Contract as a whole will cause problems, I believe in general that these criticisms are exaggerated and in part based on a faulty reading of history, which if my full testimony can be incorporated in the record of the hearing, I go into in my full testimony and I would be happy to take questions on.

Chairman ARCHER. Your full testimony will be in the written record of the committee proceedings.

Mr. BOSKIN. Thank you, Mr. Chairman.

But I believe a combination of economic analysis, common sense, and historical experience validates the general approach. And I also, with my good friend Michael Novak to my side, the moral intent and content of the items in the Contract I believe is heading in the right direction as well.

I want to spend just the rest of my brief introductory time talking about the items which are most important to this committee, which are tax items, and I would begin with a parable: When the Federal Government collects $1 of taxes from the private sector, it costs the private economy more than $1, because people out there will shelter their income or they will change their behavior, they will have to comply, and private economists have estimated these costs may be $1.40 per dollar. Maybe that is a little high, maybe a little low, but you should know that for each dollar you are imposing, $1.40 in costs on the private sector and it gets put into a bucket and it is on the way to trying to solve some problem and the bucket leaks.

There are administrative costs, bureaucratic costs. Some of these admittedly occur in the private sector as well, but they then go ahead and maybe by the end there are 70 cents or 50 cents left to address the problem. Some of those programs work well, some don't. Many of them can't be redesigned and should be scaled back efficiently. And I think if you keep that parable in mind it will be a major source of zero-based budgeting analysis.

Very briefly, the major tax items in the Contract I believe are important but could be divided into two categories. Those are designed primarily to strengthen the economy, strengthen economic growth, and those that are designed to serve other social and equity and fairness objectives.

In the former category, I would put things like capital gains depreciation, IRAs; in the latter category, things like child credits and so on. Elected officials will have to decide which of those we can afford and which to push most rapidly and what spending should be cut in order to pay for them.

I would just say that, in my view, short of a comprehensive overhaul of the income tax system of the United States, which may be something that this committee should turn its attention to in the future because the current system has so many problems, so costly, so hard to comply, so complex, but short of that, I believe the single most important item to be the capital gains reform.

The Contract calls for a 50-percent reduction in the rate and indexing and I will just make two points. Failure to index capital gains means that we are confiscating wealth. I don't think there is any Member of Congress who on an up or down vote would vote to confiscate wealth, but when people have purely inflationary gains and we are levying a capital gains tax on them, we are confiscating their real wealth. And the tax rates on their real wealth become exorbitant.

I give a simple example of 280 percent on a real gain in the text. So I would say that is by far the highest priority.

I also believe that America saves too little, that properly designed IRAs can help increase the savings rate. If we are not going to make a fundamental overhaul of the tax system—I strongly support greater opportunities for tax-deferred savings.

I would also argue that depreciation is, in my opinion, in many industries an inappropriate neutral capital. Cost recovery has certain advantages and disadvantages. My view is you ought to be moving toward a system in which there is a combination of depreciation allowances and interest deductibility that provides the equivalent of expensing.

My conclusion is simple, then. These are all highly desirable. They should be combined with sufficient spending restraint enacted either simultaneously or previously, that when combined with prudent, careful, and open estimates of any revenue reflow from the additional growth would make sure the deficit is not increased and hopefully reduced.

So I commend the Contract, its comprehensiveness. I hope this committee will work with the other committees on things like regulatory reform and other things which are hidden taxes not in the purview of this committee but are like a hidden payroll tax or excise tax and so on, the excess regulation. And I hope that the Congress will be able to move forward and enact the spirit and in some cases the letter of the Contract.

Thank you.

Chairman ARCHER. Thank you, Dr. Boskin, for your oral testimony. And as I said, without objection, your entire written testimony will be inserted in the record and the same shall apply to the other witnesses.

[The prepared statement follows:]

TESTIMONY OF HON. MICHAEL J. BOSKIN
STANFORD UNIVERSITY, STANFORD, CALIF.

Chairman Archer, Ranking Member Gibbons, and other distinguished members of the Committee, I appreciate the opportunity to share my thoughts on the "Contract with America," with you today. The "Contract" is a commitment to bring to a bring to a vote in the House ten bills, each of which contains several provisions designed to achieve important objectives. Many of these provisions are within the direct purview of this committee; still others will indirectly affect areas and issues within the jurisdiction of this committee; whereas others will have little or no impact on issues within the jurisdiction of this committee. Before beginning to discuss some of the most important items in the "Contract," especially tax provisions, within your purview, let me first make a few general remarks about the "Contract with America"; these general remarks would apply equally to the proposals put foreword before the election by Senate Republicans in their "Seven More in '94" proposals.

The broad basic theme of the "Contract with America," is that while America is the strongest, freest and richest major industrial economy in the world, it does confront serious problems, and that important, sometimes bold, policy reforms are necessary to strengthen the economy and our society. Most of these reforms have in common the theme that the federal government has overreached in a variety of programs and policies, and that, on balance, it is either not achieving the goals of those programs in a cost effective way, not achieving them at all, and/or that it is preventing the private sector--families and businesses--from realizing their full potential. Taxes are too high. The government spends too much, and inefficiently. The government borrows too much, and in general should not borrow at all except in extreme circumstances. Federal government rules and regulations put far too many restrictions on private activity, imposing large compliance costs and stifling innovation. Too much power has been centralized in Washington, and not enough devolved to the states and localities, and America's households.

Whatever disagreement with any specific item in the "Contract with America" anyone may have I believe its general analysis and prescription is exactly correct. I myself would not dot every i and cross every t exactly as in the Contract. But I believe a combination of economic analysis, common sense, and historical experience validates the general approach.

Critics have said the costs will be huge, deficits will balloon, the programs cannot work, they will be unfair, this will be a return to trickle-down economics, and ballooning budget deficits like the 1980's. While, of course, there is a risk that what comes out in the end could justify these dire predictions, I believe that they are extraordinarily exaggerated. They are also based on a faulty reading of history. Let me give a couple of examples.

Some critics argue that tax cuts in the 1980's caused the deficits to balloon, and as a corollary, that Reaganomics was predicated on the assumption that the tax rate cuts would pay for themselves by generating so much economic activity that the tax base would expand enough to compensate for the lower rates and that the deficits of the 1980's are proof that they did not. These criticisms are conventionally wisdom in some quarters. They are, however, simply incorrect.

In addition, the 1980's were quite a successful economic decade. While the deficit did balloon, 20 million jobs were created, 5 million businesses were started, the economic status of women improved relative to men for the first time ever, and most importantly, private wealth increased five times as much as the national debt. Concern about deficits is warranted under certain circumstances, but it should not blind us to the broader picture of the nation's balance sheet which improved enormously in the 1980's.

First, taxes were not reduced in the 1980's While tax rates were reduced, the share of taxes in GDP remains roughly constant at around 19 percent of GDP, about the average in the 1970's. It is true that by the end of 1980 and early 1981, the tax share and GDP rose to well over 20 percent, but that was because of roaring double-digit inflation driving people into higher tax brackets at a time when the tax system was not indexed. So a comparison to that year which was a particularly bad aberration is highly misleading. And most of the estimates of how much the tax rate reductions contributed to deficits compare to a baseline where the tax share and GDP would have gone still higher because of continued inflation, and lack of indexing. Some may accept that as the appropriate baseline, I do not. It is fair to say that the tax mix was changed some in the 1980's, with slightly higher payroll taxes and slightly lower income taxes. Second, President

Reagan never assumed in any campaign document, or budget submission, that tax reductions would "pay for themselves," despite all of the claims to the contrary. In fact, it was assumed that there would be a 17 percent revenue reflow, i.e. that when you added up all of the "static" revenue losses, that improvement in the economy from the tax cuts would generate enough activity to compensate for slightly less than one-fifth of the revenue lost. Third, the reductions in the top marginal tax rates did pay for themselves. This is well-documented in Treasury data. Some combination of increased work, saving, investment, work intensity, and importantly, desheltering, led to a situation where revenues went up, not down, from the highest income groups. It is not correct that the early 1980's tax rate reductions "paid for themselves"; the broad across-the-board rate cuts only paid for themselves in the top brackets.

Thus, purely static scoring would miss this effect, and is I believe one problem with the current methods used to evaluate major policy changes such as President Clinton's large increase in the top personal income tax rates.

So if there was some partial revenue reflow, and the tax share was stable because some modest increases in payroll taxes offset some very modest reductions in personal and corporate income taxes relative to GDP (the falloff in corporate income taxes had more to do with the decline in corporate profits relative to GDP than to any change in the effective corporate rate), why do the deficits increase? The answer is very simple: spending grew and rapidly. Relative to the size of the economy, the very large budget deficits of the early to mid-1980's were due to the fact that the spending share grew, while the tax share was stabilized.

Undoubtedly, there are many reasons this occurred. There some who believe that the most important thing for the economy is to have low tax rates; others who believe the most important thing is to keep spending under control; still others look virtually exclusively at the budget deficit. I believe all three are important, and all three are too high.

But most of all, the lesson from the 1980's is that spending grew out of control, and that in order permanently to reduce the budget deficit and, indeed, balance the budget, spending must be controlled and the economy must grow as rapidly as possible without accelerating inflation. To do that, tax rates must be as low as possible, regulation must be less extensive and more flexible, etc.

While only some of government spending falls within the purview of this committee, my first general comment with respect to delivering on the contract is to make sure that spending is cut first, or least simultaneously with taxes. Some of the tax reductions proposed in the "Contract with America" will strengthen the economy. A strong case can be made that the current methods for scoring such tax proposals bias the case against them. (Indeed, I made such a case yesterday in testimony before a joint session of the House and Senate Budget Committees). But this is not true of all tax cuts, and in general, it is important to distinguish between tax reductions which are designed to serve other purposes which have little impact on the overall economy, tax reductions which may help the economy somewhat and offset a modest amount of the static revenue lost (such as the 17 percent assumed in the original Reagan program); and those few instances where the failure to use any dynamic scoring is likely to seriously underestimate the aggregate supply response over time. The later occurs in such cases as major revisions in capital gains tax rates, saving and investment incentives, and, major changes in marginal tax rates (income, payroll, or corporate taxes).

To the criticism that exploring the idea of using, prudently, some dynamic scoring is cooking the books, my reaction would be nobody wants to cook the books, rather, they should be opened, and any changes made in methodology should be done carefully, openly, and be well within the grounds of professional estimates of the effects involved. As I mentioned in my testimony to the budget committees yesterday, it would be a mistake to start from the assumption that the books are in good shape now (for they contain many accounting problems).

In the examination of spending (and I would hope regulation as well) I would hope the committee would follow up the spirit of the change in baseline budgeting to year-over-year budgeting by examining every feature of every program. There are many government programs that ought to be reduced, eliminated, restructured or privatized, even if the government was running a surplus. So ask the tough questions: Is there a legitimate need being addressed? Is it plausible that a government program is likely to achieve this objective? Is the existing program cost-conscious and target effective? Is it justified today, not just was a good idea when implemented years or decades ago?

In asking these questions it is useful to have the following parable of the taxpayers' dollar in mind. When the government raises a dollar in taxes, it costs the private economy more than a dollar. Some taxpayer, an individual or business, sends a dollar to Washington, but the taxes distort behavior--they may lead to sheltering, reduced effort, movement of activity overseas, etc. The extra cost of these distortions, as near as economists can tell, add up to a considerable amount, perhaps 40 cents or more at the margin. So the government collects a dollar in a manner that costs the private economy $1.40. And now deposits that government dollar into a bucket. Unfortunately, the bucket leaks. It springs a leak because of administrative costs and overhead, which in general are worse in government than in the private sector. It springs another leak because of bureaucracy and political compromises, perhaps due to historical accident. In any event, by the time it gets to dealing with goal of the program, there is considerably less than a dollar left in the bucket. Perhaps it is only 50 cents, perhaps it is only 75 cents, depending on which program we are talking about. Now the 50 or 75 cents that is left over after administrative costs, overhead, etc. douses the problem. Whether transfer payments to people apparently in need, or government purchases of goods and services that it is presumed are insufficiently or in other ways inadequately provided by the private sector. Some of these funds will not go to the group for which it was originally intended. Or will only be partially successful in solving the problem. Thus, we are costing the private sector $1.40, to apply perhaps one-third to one-half of that amount to achieving the objective. That means the need must be great, and the program quite effective, to make the bang for the buck worth it from society's point of view. Of course, there are many important functions government should serve and finance, from defense to a safety net. My point is only that while it has been politically painful to try and reduce spending, I believe that a thorough examination of the government's activities will reveal far fewer programs that pass a serious hard-headed, but compassionate, social cost-benefit test.

Therefore, I support proposals and mechanisms which will force a more thorough and demanding test of desirability and acceptability.

The Major Tax Items in the "Contract with America

The major tax items in the "Contract with America" include a 50 percent reduction in the capital gains tax rate, plus prospective indexing for inflation; expansion of Individual retirement Accounts; a $500 per child tax credit; repealing the increase in the percentage of Social Security benefits subject to income taxes for elderly Americans above some modest income threshold; neutral capital cost recovery; elimination of the marriage penalty; small business incentives; and several other features which are important in and of themselves, but perhaps not as important as these to the functioning of the economy.

I would like to begin with some general remarks, then go into slightly more detail on the capital gains proposal, IRAs, depreciation, the child credit.

The tax proposals in the "Contract with America" seek to achieve a variety of objectives. Many are designed to strengthen the economy by increasing saving, investment and entrepreneurship, thereby increasing productivity and future living standards. Others are designed to redress some perceived inequity or deal with some other social problem. e.g. penalizing marriage or the historically eroded value (by inflation) of the personal exemption/child deduction/ credit. While I am sympathetic to the pro-family tax provisions, and would like to see them enacted if sufficient spending cuts and pro-growth tax incentives are enacted to pay for them, from the standpoint of economic growth, they are less important than capital gains, IRAs, depreciation, etc. I would mention that it may be possible to assist those families in a way that additionally helps incentives by lowering their marginal tax rates instead, but that is perhaps a less direct and obvious solution to the issues promoting these features of the tax code have in mind. Again, I am sympathetic to their objectives, but I believe it is important to keep distinct what is likely to lead to a healthier economy, and from what may be more desirable on other grounds.

Capital Gains Reform

In my view, short of a comprehensive overhaul of the corporate and personal income tax system, capital gains reform is the highest priority tax policy to strengthen economic growth.

The "Contract with America" calls for a 50 percent reduction plus prospective indexing. Let me start with indexing. The fact that citizens are taxes on purely inflationary gains is simply outrageous. This amounts to a confiscation of their real wealth. I doubt there is a single member of Congress who, on an up or down vote, would favor some other form of wealth confiscation. It is inconsistent with our basic democratic institutions and economic principles. Because we tax purely inflationary gains, it is possible for taxpayers to face immense effective tax rates on real gains. If a family bought an asset for $10,000, and sold it for $20,000, and hence had a $10,000 gain during a period when the price level tripled, they would be paying capital gains taxes on a $10,000 real loss! If the price level had only gone up 90 percent, they would be paying capital gains taxes on $10,000 of nominal gains, when their real gain was only $1,000. This would convert (at the 28 percent maximum rate) a capital gains tax of $2,800 into a 280 percent tax on their real gain. I would hope that every single member of Congress would agree to some straight-forward simple method of indexing capital gains. It should not be a political football, it is a simple question of fairness and efficiency in the tax code.

The capital gains tax is, in part, a tax on entrepreneurship and creating wealth. It stifles the flow of capital to new businesses that are an important source of new job growth, new innovations and products for American and the world's consumers. Worse yet, it locks capital in place. To sell an asset that has appreciated in value (even if it is only an inflationary increase!), the taxpayer must pay the tax in order to free up the funds to invest in other productive activities. Worse yet, they must pay a certain tax today, to seek out opportunities for higher gains to tomorrow, which are, in the very nature of economy, uncertain. So the extent of the lockin is even more powerful than the rate itself would suggest, because people have to be rewarded with a risk premium in higher expected returns to sell an appreciated asset, pay the capital gains tax now, and take the chance on a better investment down the road. There are numerous estimates of the extent of the lock-in effect, and I believe it is conceptually quite difficult to measure how much capital is locked in and the full effect. I do believe it is trillions of dollars. Whether it is two or three, or six or seven, trillion, is hard to say, but the beneficial effects from unlocking this capital would be substantial.

Next, reducing the capital gains tax rate would increase the prices of all assets eventually subjected to capital gains taxes. All economic models predict, theoretically and econometrically, that this would lead to an expansion of economic activity. By the way, this asset price effect is not included in the micro-economic behavioral responses estimated by the Treasury and the Joint Tax Committee.

Finally, and most importantly, a reduction in the capital gains tax would increase the supply of entrepreneurs, and perhaps also the supply of capital into entrepreneurial activity (although much of that is provided from currently tax free institutions). This effect is the most difficult to quantify in econometric models, but probably the most important from the standpoint of the long-term health of the economy.

Finally, traditional business investment would increase with a reduction in the capital gains tax rate, because the cost of capital would be reduced.

The estimates currently available on the cost of the capital gains proposals in the "Contract with America" are, in my opinion, seriously distorted. I believe the revenue lost would be substantially less, for all the reasons noted above.

I recall during the Bush Administration, when we proposed a 30 percent capital gains tax rate cut, that in my testimony I estimated how small the beneficial impact on the economy would have to be to overcome the Joint Tax Committees estimate of the static revenue lost (the Bush Treasury estimated a small static revenue gain). The result may surprise you. It only took an improvement in the economy of four one-hundredths of one percent per year to overcome the (perhaps cautiously estimated) static revenue lost. Even that modest rate cut would have had far greater beneficial impact on the economy.

So I urge you to move forward with capital gains tax reform: rate reduction and indexation. It is extremely important to the efficient functioning of our capital markets, the supply of capital to new businesses, and most importantly, greater entrepreneurship, innovation, and job creating investment in the economy.

IRAs

I strongly support proposals to reduce the double (and in the case of corporate equity, sometimes triple) taxation of saving in our tax system. America saves too little as a nation. The national saving rate--the sum of saving done by households, businesses, and governmental units--is far below that than any other industrialized country. Because America is such a strong, large, flexible, open, and dynamic economy, we have been able to finance considerable investment with foreign capital. It would be better still if the saving rate were higher, which would increase the investment rate still further, at least in the long-run (in the short-run, it may primarily reduce our current account deficit).

Further, numerous studies suggest that a large fraction of Americans are not saving adequately for their retirement. This combines with demographic trends to suggest even greater pressure on governmentally financed retirement support. We should be moving in the other direction, enabling people to save more for their own retirement (and other purposes).

Unfortunately, recent tax changes have clobbered private saving. I am a strong proponent of low marginal tax rates, and would have opposed the large increased in marginal tax rates in 1993 in any event. But it is important to understand the deficit only becomes a problem if it decreases the amount of saving available to finance private investment of various types. Thus, whatever other reasons to object to the higher income tax rates--and there are many--it is purely circular to raise taxes that heavily hit private saving in order to reduce the deficit in order to reduce the drain on private saving! The 1993 tax rate increases heavily hit private saving because it tends to hit households in their peak earning and saving years, very high income people with high propensities to save--and small business profits. Eighty percent of American businesses are unincorporated and, if their profits are high enough, pay the new higher tax rates and the personal income tax. The same is true of the 42 percent of corporations which are subchapter S corporations. While the Treasury estimates that only two or three percent of small businesses are so affected, the share of small business profits--available to finance job-creating investment--is much larger. It is also true that the number of such small businesses that are subject to the higher tax rates over a span of years, rather than any single year, is much higher. Not surprisingly, the personal saving rate has declined at about a $60 billion annual rate following the 1993 tax increases.

Finally, there are those who argue that IRA-type vehicles merely result in people shifting taxable funds into tax-deferred funds. While undoubtedly some of this occurred in the early 1980's, my reading of the evidence is that most American households would only be able to do this for a short period of tine, and that just as IRAs were limited in 1986, we were approaching a time when a much larger fraction of saving in IRAs was net new saving, rather than tax arbitrage saving.

I might also add that the accounting in the budget for tax-deferred saving would be illegal if these sort of books were part of a publicly-traded private corporation. The taxes are deferred, not forgiven. Treasury counts as static revenue lost, even ignoring for the moment the potential improvement in the economy, and the revenue feedback that may flow therefrom if the inside buildup in IRAs is at a higher rate than the Treasury's borrowing rate, which is quite likely given a large fraction will be invested in private securities. The present value of revenue to the Treasury may actually increase whereas the conventional accounting records a loss and no corresponding deferred taxes due asset.

Depreciation

Proper depreciation has been a subject of debate for decades among economists and policymakers. My own view is that it is extremely difficult to measure true economic depreciation, as would be required in a hypothetically-ideal income tax. That is because in today's economy a large fraction of the decline in the value of assets has to do with technological obsolescence, not just wear and tear. This is conceptually measurable only for those products with extremely active second hand markets. The product life cycles are so rapid for many products, that second-hand markets barely exist. In any event, from a purely tax theoretic point of view, I believe the appropriate tax treatment would be any combination of interest deductions and depreciation which is the equivalent to expensing. This would result in neutrality across asset types, and between investment and consumption. It would also greatly simplify the tax code. However, tax policy reforms in the past have stumbled over the proper treatment of interest deductibility. It is possible that the tax code could wind up subsidizing investment if depreciation is rapid and is debt-financed with full deductibility of nominal interest.

Conclusion

My conclusion is simple. The tax proposals contained in the "Contract with America" are all highly desirably. They should be combined with sufficient spending restraint--enacted either first or simultaneously--that combined with prudent, careful and open estimates of any revenue reflow from additional growth would make sure that the deficit is not increased and indeed, hopefully reduced substantially over time. While elected officials should decide on priorities among types of issues, from social policy, to economic growth, let me repeat what I said above: the capital gains reforms, IRAs, depreciation reform, are the components which are likely to contribute to stronger economic growth. The other reforms are desirable to redress inequities if sufficient spending cuts can be found to finance them.

Let me also repeat that the comprehensive nature of economic reform contained in the "Contract with America" is to be commended. The answers to many of the problems constraining America's economic potential do not rest exclusively in the tax code. Regulatory reform, tort reform, spending control and reduction, welfare reform are all quite important. In fact, the spending on many of these items--whether through the public purse or by the private sector in compliance costs foregone innovation--can be thought of as a large hidden tax on the American economy. Just for federal regulatory compliance, private estimates run four to five hundred billion dollars a year, the annual yield of federal payroll or personal income taxes, respectively. In addition to the important work you do on tax reform and reduction, I hope you work along with your colleagues on other committees in the House, and your colleagues in the Senate to push forward the broader reform agenda as well.

Chairman ARCHER. Our next witness is Kate O'Beirne with The Heritage Foundation. Welcome. We are pleased to hear your testimony.

STATEMENT OF KATE WALSH O'BEIRNE, VICE PRESIDENT, GOVERNMENT RELATIONS, THE HERITAGE FOUNDATION

Ms. O'BEIRNE. Thank you, Mr. Chairman. I am delighted to be here. I come before you as a frustrated Washington welfare reformer, as the Chairman might remember. We tackle welfare reform in Washington on a cyclical basis, and when we last tackled welfare reform in 1986, I was at HHS. My primary responsibility on behalf of the administration was welfare reform.

Mrs. Johnson and the Chairman worked tirelessly to actually have a proposal that met the high-blown rhetoric of radically reforming the welfare system. We spent countless hours, as I said, with Mrs. Johnson's tireless energy. Notwithstanding the talent of such people, in a typical Washington fashion, we spent billions of dollars of new money, less than 1 percent of the caseload 6 years later is working. In fact, within 1 month of passing that bill, of President Reagan signing this bill, CBO estimated that its net effect would be to increase the welfare rolls. This passes for welfare reform in Washington.

I am truly delighted, given my past frustrations, that the Personal Responsibility Act in your Contract holds the promise to truly revolutionize our welfare system and begin to end the cycle of dependency. To achieve this, welfare costs must be controlled. Illegitimacy must be reduced, serious work requirements must be established, all of these things your Contract plainly addresses.

In accomplishing these objectives, State flexibility with very few Federal requirements must be greatly expanded. Governors must be free from Federal micromanagement in order to reform their own State welfare bureaucracies. To begin with, the cost of welfare, policymakers should recognize one overriding fact. The war on poverty has failed. You will not find anybody defending it here in Washington, not openly defending it. It has been 25 years since it was launched. The $5.3 trillion spent on welfare to date has only exacerbated what Senator Moynihan has aptly called behavioral poverty.

During this period, since the war on poverty was launched, the official poverty rate has remained virtually unchanged, the family has collapsed, illegitimacy has skyrocketed, and crime has escalated in direct proportion with welfare spending.

The total annual cost of welfare spending now exceeds Federal and State spending, $324 billion a year. After adjusting for inflation, welfare spending is now nine times greater than when the war on poverty was launched in the midsixties. The notion that the United States would spend $5.3 trillion on the war on poverty would have dumfounded Washington in the midsixties.

In launching the war on poverty, it was nobody's intent that such spending was in the future. President Johnson promised nobody open-ended entitlements and constant expansion of the welfare state. He spoke instead of a temporary investment much like the talk you hear today from some quarters that would help the poor to become self-sufficient and join mainstream society. The growth of the welfare state is unending and relentless. The theme has been spend more and demand less.

According to the Congressional Budget Office, total annual welfare spending will rise to $538 billion, 6 percent of GNP by 1999. By that year, the United States will be spending $2 on welfare for every $1 spent on national defense. Welfare spending has to be front and center of any attempts to begin controlling this monster inadvertently created 25 years ago.

The Contract also recognizes the key cause for long-term dependency, and that is the illegitimate birth rate. Currently, as you know, one in three children nationwide is born to a single parent. The welfare problem is not merely the high level of spending, it is that all welfare expenditure is replete with perverse incentives that promote self-destructive behavior among the poor, such as illegitimacy. Out-of-wedlock births are at the core of the expansion of the welfare state as well as many other social problems.

The most important behavioral change to emphasize in reforms should be the promotion of stable two-parent families. As Jack Kemp has noted, homes headed by one parent have a poverty rate of 55 percent, while with two-parent families it is merely 7 percent. The collapse of the family and the rise of illegitimacy is the number one social and economic problem facing America and should remain front and center in your welfare reform efforts.

The Federal Government simply must get out of the business of subsidizing illegitimacy. Money should be shifted to new programs and the Governors given flexibility to care for these young families which would lead to higher quality of life without directly subsidizing such self-destructive behavior.

Serious work requirements must be addressed. Your Contract makes a terrific step in this direction. The growth of the welfare state has coincided with the decline in labor force participation and in 1960, among the lowest income quintile of the population, nearly two-thirds of households were headed by persons who worked. By 1991, this had fallen to about one-third, with only 11 percent working full time.

Welfare payments have a direct correlation, solid research tells us, between welfare spending and work disincentives. The major effect of cash welfare payments is to decrease the work effort. If able-bodied recipients can't find a job, they should be required to perform community service. Some of our most successful county experiments have been these community service jobs.

I am anxious to take questions from the committee and engage on the full range of issues I have addressed in my direct testimony.

Let me just make a quick point to underscore the point that Michael Novak has made. We cannot forget who our true allies are in this fight to help low-income children and families to help begin to rebuild families and save children.

Dealing with social problems through greater reliance on nongovernmental social institutions is nothing new. It is a return to the fundamental political philosophy upon which the American republic was established. Our Founding Fathers placed little reliance on government as a cure for social ills. The wisdom is reflected in the writings of Alexis de Tocqueville. He placed a crucial emphasis on the roll in American society of "private association such as religious institutions, private philanthropy clubs, fellowships, voluntary civic organizations, and private moral and educational institutions." According to de Tocqueville, these private associations or civil institutions which bad government policy has driven out were more important than America's political and economic institutions.

The welfare system desperately needs reform, real reform, and this time we have an opportunity to truly meet the promise of real reform. We can convert welfare from a one-way handout into a system of mutual responsibilities in which welfare recipients would be given aid but would be expected to contribute back.

A reform system must strongly discourage dependency and the irresponsible behavior it is currently subsidizing. It must permit the Governors to begin to work with private groups in their States to rebuild a civic society where families, neighbors, churches, and communities commit their energies and resources to helping the poor in their midst.

We have to control welfare costs. I shared with you what is going to happen over the next 4 years if we fail to do so. And welfare reform must seek to reduce the illegitimate birth rate in the United States and promote the formation of two-parent families.

I look forward to any questions you might have. Thank you, Mr. Chairman.

[The prepared statement follows:]

Testimony Before
The Committee on Ways and Means
U.S. House of Representatives
January 11, 1995

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The Personal Responsibility Act is aimed at revolutionizing the welfare system and ending the cycle of welfare dependency. To achieve this, Members of Congress must: 1) control welfare costs; 2) reduce illegitimacy; and 3) institute serious work requirements. In accomplishing these objectives, state flexibility with federal requirements must be greatly expanded.

CONTROL WELFARE COSTS:

To begin with, policy makers should recognize one overriding fact: the " War on Poverty" has failed. It has been over 25 years since President Lyndon Johnson launched his "unconditional war." The $5.3 trillion spent on welfare to date has exacerbated what Senator Moynihan has called "behavioral poverty." Instead, during this period, the official poverty rate has remained virtually unchanged, the family has collapsed, illegitimacy has skyrocketed, and crime has escalated in direct proportion to the growth in welfare spending. The total annual cost of U.S. welfare spending now exceeds $324 billion, with spending since the mid-sixties increasing in every year except one. Welfare spending in FY 1991, FY 1992 and FY 1993 exceeded defense spending for the first time since the 1930's, with spending per capita today being five times as high as during the Great Depression, when a quarter of the work force was unemployed. After adjusting for inflation, welfare spending is now nine times greater than when Lyndon Johnson launched the "War on Poverty" in the mid-sixties.

The notion that the U.S. would spend $5.3 trillion on the "War on Poverty" would have dumbfounded the Washington Community in Lyndon Johnson's day. In launching the "War on Poverty," President Johnson did not promise an open-ended expansion of the welfare state. Instead, he spoke of a temporary investment that would help the poor to become self-sufficient and join mainstream society. But the growth of the welfare state is unending and relentless. The theme has been spend more and demand less. Moreover, there is not even the faintest glimmer of "light at the end of the tunnel" for the end of the "War on Poverty." According to the Congressional Budget Office figures, total annual welfare spending will rise to $538 billion and six percent of GNP by 1999. By that year, the U.S. will be spending more than two dollars on welfare for each dollar spent on national defense.

The long history of bogus welfare reforms, all of which were promised to save money but did not, leads to one obvious conclusion. The only way to limit the growth of welfare spending is to do just that: limit the growth of welfare spending. For example, consideration should be given to capping the future growth of aggregate federal spending on these welfare programs (excluding Medicaid) at 3.5 percent per annum. This cap on aggregate welfare spending would save the federal government more than $70 billion over the next five years. Under the cap, individual programs could grow by more than 3.5 percent as long as total spending growth on all programs does not exceed 3.5 percent.

With a cap on future federal funds, state governments would, for the first time, be forced to adopt innovative and aggressive policies that would reduce the welfare rolls. Under the cap, federal welfare funds should be given to each state government as a block grant. The state would be required to use the funds to aid low-income persons, but would be given broad authority to set eligibility standards for all welfare programs. States also would be given authority to shift funds between programs (today they have only limited authority if granted a federal waiver). For example, a state should be able to use housing funds for job training or vice versa, according to state priorities. Similarly, states should be able to use the funds to operate new welfare programs of their own design. For example, if a state wished, it might operate one food program of its own design in lieu of ten separate federal programs.

REDUCE ILLEGITIMACY

The welfare problem is not merely the very high level of spending; it is that nearly all welfare expenditure is replete with perverse incentives that promote self-destructive behavior among the poor, such as illegitimacy. Out-of-wedlock births are at the core of the expansion of the welfare state as well as many other social problems. The most important behavioral change to emphasize in reforms should be the promotion of stable two-parent families. As Jack Kemp has noted, "Homes headed by one parent have a poverty rate of 55 percent, while with two-parent families it is just 7 percent.

The collapse of the family and rise of illegitimacy is the number one social and economic problem facing America. Family disintegration is the primary underlying factor driving a whole range of other social problems, including crime, poverty, welfare dependence, drug use, and school failure. A future welfare system in which half of all children are born out of wedlock while their mothers are placed in government make-work jobs and their children are raised in government daycare centers will be more expensive than the current welfare system and will not stem the other crucial problems arising from family collapse.

Under current law, having a child out of wedlock is directly subsidized by the federal government. The federal government should never have been in the business of saying, in effect, to an 18-year-old girl: "If, and only if, you have a child out of wedlock, we will send you a check in the mail." The present welfare system, by paying young women to have children out of wedlock, encourages them in a course of action that in the long term proves self-defeating to the mothers and harmful to both the children and society. If you got pregnant in 1960, you received a welfare package worth about $5,000 per year, mostly in cash. But if you got pregnant in 1970, you received a package worth over $12,000 per year, including cash, food, and medical care -- all absolutely guaranteed by the federal government. All you have to do to get the $12,000 is agree not to work and not to get married. Is it surprising then that the illegitimacy rate went from about 4 per 100 births in 1960 to about 10 per 100 in 1970, more than doubling in 10 years -- just as the value of the welfare package more than doubled?

Our current system is based on perverse incentives which effectively block the formation of intact, two-parent families. According to Nick Zill of Child Trends, Inc., 43 percent of long-term welfare recipients started their families as unwed teens. They are **long-term** recipients because the system does not offer them a way out through marriage (where the poverty rate is only seven percent). It is recognized increasingly that only by making illegitimacy more inconvenient, what economists would call raising its opportunity cost, will the out-of-wedlock birthrate be reduced.

The federal government must get out of the business of subsidizing illegitimacy. Money should be shifted into new programs to care for future illegitimate children, leading to a higher quality of life for those children without retaining the incentives which induce out-of-wedlock births in the first place.

Conventional welfare for young women who, in the future, have children out of wedlock must be eliminated. However, the government should not simply abandon all aid to children born out of wedlock. Funds currently given directly to young unwed mothers should be converted into block grants to the states, and the states should be prohibited from using these funds for conventional welfare payments. Instead, states could use the funds for a wide variety of alternative programs designed to discourage illegitimate births and to care for the remaining children born out of wedlock. Funds could be used for such things as promoting adoption, closely supervised group homes caring for unmarried mothers and their children, pregnancy prevention programs , or any other program devised by the state to cope with the crisis of illegitimacy.

Also under the current welfare system, if a mother enrolled in AFDC bears additional children, she receives an automatic increase in her AFDC and Food Stamp benefits. No other family in U.S. society receives an automatic increase in its family income if it has more children. There is no reason to provide expanded welfare benefits to single mothers who have additional illegitimate children after they are already dependent on welfare.

Current law requires that an AFDC mother must make a "good faith" effort to identify the father of the child in order to receive AFDC. This law is ignored. The government should require, for children born after January 1994, that the mother must identify the father of the child in order to receive AFDC or Food Stamps. Exceptions to this rule in a few hardship cases could be given, but the exceptions should not exceed ten percent. Once the mother has identified the father and paternity has been established, the father can be required to pay child support to offset welfare costs. If the father claims he cannot pay any child support because he cannot find a job, the government may require community service work from him to fulfill his obligation.

Experiments with this approach in Wisconsin have led to surprising increases in the ability of absent fathers to locate private sector employment and pay child support. Moreover, the definite expectation among young men that they will be identified as fathers and required to pay child support for their children may put an end to the ethos in some communities where young men assert their masculinity by fathering children they have no intention to support.

INSTITUTE SERIOUS WORK REQUIREMENTS

The growth of the welfare state has coincided with a decline in labor force attachment. In 1960, among the lowest income quintile of population, nearly two-thirds of households were headed by persons who worked. By 1991 this figure had fallen to around one-third, and only 11 percent had household heads who worked full time throughout the year. Par of this decline in employment can be attributed to the increasing number of retired elderly households in this income group, but an equally important factor is the decline in labor force participation among non-elderly heads of households.

For a growing number of poor Americans, the existence of generous welfare programs makes not working a reasonable alternative to long-term employment. During the late 1960s and early 1970s, social scientists at the Office of Economic Opportunity (OEO) conducted a series of controlled experiments to examine the effect of welfare benefits on work effort. The longest running and most comprehensive of these experiments was conducted between 1971 and 1978 in Seattle and Denver, and became known as the Seattle/Denver Income Maintenance Experiment, or "SIME/DIME."

Advocates of expanding welfare had hoped that SIME/DIME, and similar experiments conducted in other cities, would prove that generous welfare benefits did not adversely affect "work effort." Instead, the SIME/DIME experiment found that every $1.00 of extra welfare given to low-income persons reduced labor and earnings by $0.80. The significant anti-work effects of welfare benefits were shown in all social groups, including married women, single mothers, and husbands. The effects were particularly pronounced among young unmarried males; among this group the number of hours worked per week declined 43 percent for those who remained unmarried throughout the experiment and 33 percent for those who married. The results of the SIME/DIME study are directly applicable to existing welfare programs: Nearly all have strong anti-work effects like those studied in the SIME/DIME experiment.

Recent research by Dr. June O'Neill of Baruch College in New York City has confirmed that higher welfare benefits increase the number of individuals who leave the labor force and enroll in welfare. A 50 percent increase in monthly AFDC and Food

Stamp benefit levels was found to lead to a 75 percent increase both in the number of women enrolling in AFDC and in the number of years spent on AFDC. In other words, increases in benefits' value causes a dramatic expansion in welfare caseloads.

An extremely important research discovery by Dr. O'Neill is that high AFDC benefits reduce the employment of young adult men in a community even though few, if any, of these men are direct beneficiaries of AFDC payments. High AFDC benefits were found to reduce the employment of young adult men in a community by some 50 percent. The high AFDC benefit levels apparently affect the work behavior of young men in two ways. First, high benefits reduce the probability of marriage and thereby reduce the necessity for a young man to work to support a family. Second, it is likely that many young single men who are boyfriends to single mothers on AFDC indirectly share in the mother's welfare benefits; higher benefits thereby reduce the male's need for work.

Real reform would convert welfare from a one-way handout into a system of mutual responsibility in which welfare recipients would be given aid, but would be expected to give something back to society for that assistance. Many welfare recipients themselves see nothing wrong with this. Jennifer Allen, a welfare single mother in Wisconsin's Learnfare, commented in a March 15, 1992 "Insight" magazine article that "if people are motivated and they want to get off welfare, get a job and support themselves and their families -- then those are the people welfare should try to help. If people are lazy and don't want to be helped, then fine, cut their benefits. If they don't want to help themselves, why should anyone else help them?"

If able-bodied welfare recipients cannot find a job, they should be required to perform community service. Requiring recipients to work for their benefits would eliminate the work disincentives of welfare. No longer would welfare subsidize and encourage non-work; nor would it continue to discourage recipients from taking available private employment, because they would have to work in any event. Marvin Olasky emphasizes this in his Fall 1990 Policy Review article when he stated, "Poverty fighters 100 years ago...made moral demands on recipients of aid. They saw family, work, freedom, and faith as central to our being, not as life-style options. They did not allow anyone to eat and run."

The key to successful workfare lies with five rules:

1) Require single males, fathers on welfare, and single mothers with older children to work before requiring mothers with pre-school children to work. It is important for these people to work before mothers with pre-school children, not only because it is a sound social policy, but because the program is 60 to 80 percent less expensive to operate without high daycare costs.

2) Require at least half of all AFDC parents to work in exchange for existing benefits. In the past there has been much talk, little action. And again, emphasis should be placed on fathers and those women with older children.

3) Do not provide a two year exemption from work requirements. Up front work requirements are the most cost-effective of all dependency reducing measures.

4) Establish effective workfare programs requiring continuous full-time participation and linking payment of welfare benefits to successful work performance. The work requirement should be in place as long as the recipient receives welfare, and the work should be continuous, not sporadic.

5) Recognize the ineffectiveness of government training programs. Despite over three decades of experience, the government has never been able to run training programs that raise the wage rates of welfare recipients by more than a tiny amount. The U.S. Department of Labor's own evaluation of the Job Training Partnership Act program showed the program had little effect on the wages of trainees. The average hourly wage of female trainees was raised by 3.4 percent; the hourly wages of males were not increased at all. To the extent training is provided, all programs should undergo scientific evaluation, and the programs which do not produce significant increase in hourly wage rates should be terminated.

Research on pilot projects in Ohio shows that rigorous workfare programs dramatically reduced welfare dependence. Designated welfare recipients were required to perform community service for at least 20 hours per week. This work requirement was continued as long as the individual received welfare benefits. This approach differed greatly from conventional short term workfare programs which require recipients to work for a few months but then suspend the work obligation and allow the recipient to continue to receive benefits without further work obligation.

In the Ohio programs, around 25 percent of single mothers on AFDC were required to perform community service (workfare) in exchange for the welfare benefits they received. The requirement resulted in an overall reduction in the AFDC single mother caseload of 11.3 percent.

Similar reductions were seen in the Aid to Families with Dependent Children-Unemployed Parent program (AFDC-UP), which provides welfare to two parent families. Eighty percent of AFDC-UP fathers were required to participate in workfare, resulting in a 34 percent reduction in the AFDC-UP caseload.

The Ohio workfare programs are, by far, the most successful dependency reduction programs so far evaluated. The effects on both AFDC and AFDC-UP caseloads are far larger than the effects reported for conventional job search and training programs elsewhere in the country. (Source: Bradley R. Schiller and C. Nelson Brasher, "Effects of Workfare Saturation on AFDC Caseloads," Contemporary Policy Issues, Spring 1993.)

Other states have shown that work requirements can dramatically reduce welfare dependence, at least in the AFDC-UP program. In 1983, Utah established the Emergency Work Program (EWP) in place of traditional AFDC-UP program for two parent families. EWP established one of the most stringent and comprehensive workfare systems yet known. Male parents of welfare families were required to participate in organized activities for 40 hours per week: 8 hours of job search and 32 hours of community service work or education and training. These requirements were rigorously enforced.

EWP offered some education and skills training in addition to community service work and job search. However, education and training did not increase the employability of welfare recipients relative to participation in other activities. A final unusual feature of EWP was a work/job search requirement imposed on both spouses in some families. Work requirements on both spouses rose from 5 percent of caseload initially to 61 percent in EWP's third year.

The Utah experience shows the clear effectiveness of serious work requirements in dissuading individuals from enrolling in welfare and becoming dependent. Despite eligibility criteria which were identical to Utah's prior AFDC-UP program, average monthly caseload during the first four years of EWP was 194 compared to an average caseload of 1,800 under AFDC-UP. These dramatic caseload differences were achieved despite the overall similarity in economic conditions between periods of comparison. EWP also shows the effect of required work in promoting quick exits among families who become enrolled in welfare. The average length of stay of families on EWP was 2.5 months compared to 10 months in Utah's AFDC-UP program. Overall, the EWP program with its firm work and job search requirements reduced welfare costs by 92 percent compared to the prior AFDC-UP program which had only minimal work requirements. (Source: Frederick V. Janzen, and Mary Jane Taylor, Emergency Welfare Work and Employment: an Independent Evaluation of Utah's Emergency Work Program Final Report 1984-1991. Salt Lake City: The Social Research Institute, Graduate School of Social Work, University of Utah, June 13, 1991.)

Finally, much of this spending is simply extravagant. A clear example of waste in the welfare system is the growing number of non-citizens receiving welfare. Immigration should be open to individuals who wish to come to the United States to work and be self-sufficient, but it should not become an avenue to welfare dependence. Prudent restrictions on providing welfare to recent immigrants has long been part of the American tradition. Immigration laws passed by Congress in 1882 instructed immigration officials to deport any person who, in their opinion, might become a public charge. Today, the Immigration and Nationality Act declares unequivocally "any alien who, within five years after the date of entry, has become a public charge from causes not affirmatively shown to have arisen since entry is deportable."

Today, non-citizens are among the fastest growing groups of welfare dependents. In 1993, there were nearly 700,000 lawful resident aliens receiving aid from the SSI program. This was up from 128,000 in 1982: a 430 percent increase in just ten years.

Total welfare costs for non-citizens in the SSI program now approach $7 billion per year. The overwhelming majority of non-citizen SSI recipients are elderly. Most apply for welfare within five years of arriving in the U.S.. These SSI recipients are concentrated in a few states. Five states alone (California, New York, Florida, Texas, and New Jersey) account for nearly 80 percent of the total.

The presence of large numbers of elderly immigrants on welfare is a clear violation of the spirit, if not the letter, of U.S. immigration law. The relatives who sponsored the entry of these individuals into the U.S. implicitly promised that the new immigrants would not become a burden to the U.S. taxpayer. But many, if not most, sponsors are enrolling their elderly immigrant relatives on welfare soon after the end of the three year waiting period. Once on SSI, there is every indication that these immigrants will remain on welfare indefinitely.

While we all greatly sympathize with those individuals who have suffered from political oppression and economic failure inherent to communist regimes, we must not attempt to use U.S. welfare programs to redress that suffering. Just as the U.S. military cannot serve as a global policeman, U.S. welfare programs cannot serve as a global retirement system. This should be the role of churches and community service organizations, such as the Indochinese Community Center, where a former Laos immigrant (now a U.S. citizen) established a place where immigrants receive help in demystifying the immigration process; take classes in history, civics and English; receive emergency food and clothing; and receive job training and job placement for senior citizens who have been political prisoners.

Congress should eliminate welfare eligibility for all non-citizens. Congress should also ensure that the sponsoring individuals who were responsible for bringing elderly relatives to the U.S. in the first place bear the full and permanent responsibility of supporting their immigrating family members. In a limited number of cases in might be necessary to continue some form of federal aid. Some non-citizens on SSI may lack relatives to support them, and may be unable to return to the politically oppressive nations from which they emigrated. Such elderly individuals, who are true political refugees, who are incapable of self-support, and who lack supporting relatives should receive aid under federal refugee programs.

EDUCATIONAL CHOICE

Even before the "War on Poverty" began, receiving an education was recognized as the best way to avoid poverty. Students who drop out of high school or who receive public assistance at an early age are much more likely to become welfare dependent than students who complete their education. To address this problem, some states have enacted a Learnfare program. Learnfare requires school-aged children receiving AFDC benefits to attend school regularly or face a reduction in AFDC benefits. It also requires teenage mothers on AFDC to continue school unless they have completed high school or have received an equivalency degree. Failure to meet attendance requirements results in the mother or child being removed from the AFDC until regular attendance is re-established. The threat of reduced welfare benefits gives parents an incentive to make sure their children regularly attend school. The Learnfare program also ensures that young mothers on welfare complete their education and thus reduces the likelihood of prolonged welfare dependency.

Unlike nearly half of all Chicago public school teachers who send their own children to private schools, the poor do not have the choice to "opt out" of dismal public schools. And unlike middle - and upper-class Americans, who can afford to either purchase homes in the suburbs or choose private schools, the poor are "left behind" with an increasingly sub-standard education. The poor's inability to choose alternative providers of education leaves them little or no leverage in dealing with the public school bureaucracy. But poor children and their parents will gain leverage only when their status with the public school monopoly changes from "guaranteed clients" to "education consumers." The poor must be given the opportunity to take their business elsewhere.

The welfare system desperately needs reform. Real reform would convert welfare from a one way hand-out into a system of mutual responsibility in which welfare recipients would be given aid but would be expected to contribute back to society for assistance given. A reformed system must strongly discourage dependency and irresponsible behavior and encourage constructive behavior. It must firmly control soaring welfare costs. Finally, and most importantly, welfare reform must seek to reduce the illegitimate birth rate in the U.S. and promote the formation of stable two parent families. Any reform which does not dramatically reduce the illegitimate birth rate will not save money and will fail to truly help America's children.

Chairman ARCHER. Thank you, Ms. O'Beirne.

Our next witness and last witness on this panel is a man who has been before this committee a number of times, Dr. Barry Bosworth, senior fellow at the Brookings Institution.

Dr. Bosworth, we would be pleased to hear your testimony.

STATEMENT OF BARRY P. BOSWORTH, PH.D., SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. BOSWORTH. Thank you, Mr. Chairman. I wish to thank this committee for this invitation to comment on the economic consequences of the budgetary changes embodied in the Republican Contract. The last election truly initiated a momentous change in the structure of the Congress and our new leadership and many new Members. I think hopes are very high in this country that this Congress will finally begin to deal with the enormous fiscal problems that this country faces.

I, too, have observed the election outcomes and I agree that American voters have voted for a smaller and more efficient government. There are too many government programs that are not working well. Some programs will need to be eliminated and others will need to be redesigned to be more efficient.

But where I strongly disagree both with President Clinton and with the Republican Contract is in their promotion of the idea that this whole process can be preceded by another round of tax reductions. I think the priority has to be to reduce the public-sector budget deficit. It is the fundamental problem that is destroying the economic condition of the American economy.

I am not going to review all the arguments for or against the various proposals to reduce expenditures, except to note that they are certainly smaller and far less specific than the proposals to cut taxes. We have been down this road before with vague targets for expenditure cuts and hard commitments for tax reductions. We would do well not to forget the missing expenditure cuts of 1981 or the futility in the mideighties of the Gramm-Rudman-Hollings legislation that set targets to the budget deficit reduction that were never realized.

We would all like to pay less taxes and tax cuts will always be politically popular, but given the deficit and the vague promises of expenditure cuts, the focus on tax cuts instead of deficit reduction is a serious distortion of the priorities that this Congress has to address.

We have to look beyond the next year and beyond the next election and reflect on the cost of our actions to future generations. I understand the attractiveness to families with children of another round of tax reductions, but what they really ought to be concerned about is the inheritance they are passing on to those children. A future burdened down by massive public deficits, an astoundingly low rate of national saving in this country, and continued increases in interest rates that put the price of a home beyond the reach of an increasing number of young Americans.

Second, the elderly already receive benefits through this budget that absorb nearly half of all expenditures. Given the extent to which those benefits exceed any past contribution, I think their case for special treatment and concessions on the tax side is particularly weak. They ought to be far more concerned about the exploding financial problems that are occurring in our social programs for the elderly and particularly the looming deficit that is emerging in the Medicare program.

Third, I believe that the proposals for tax relief on the business side are a serious misdiagnosis of the problem of capital formation in the United States. There is no shortage of incentives for new investment. In fact, business investment in the last 2 years has been booming. The problem is there is no saving to finance it. And so when investment takes place in this country, in fact it is financed by borrowing from foreigners. And Americans are just steadily running up debts with the rest of the world, our own public sector, and our personal accounts trying to pay for a consumption binge that can't be sustained, and I think this Congress has to address this fundamental problem of reducing the deficit, and it should be the first and only priority of the new Congress.

Let me just end with a couple of things about some other provisions. I, too, at times like the idea of a balanced budget amendment. I get very frustrated with the inability of this Congress to sit down and do its job over the last decade. And I might be willing to promote it, except that fundamentally I guess it is going to turn out like prohibition: It won't work. And what really worries me about it is it will be ineffective and is being used as a device to postpone taking action. Frankly, the year 2002 is forever when it comes to dealing with the budget deficit. It is way too far in the future.

I will stop with those remarks and take questions. Thank you.

[The prepared statement and attachments follow:]

Testimony of
Barry P. Bosworth[1]
before the
Ways and Means Committee
of
the United States House of Representatives

I wish to thank this committee for the invitation to comment on the economic consequences of the budgetary changes embodied in the Republican contract. The last election initiated a momentous change in the structure of the Congress with a new leadership and many new members. Hopes are high that the new Congress will address the enormous fiscal problems of the federal government that have been a core cause of the deterioration in the performance of the economy over the past two decades.

I, too, have observed the election outcome and agree that the American voters have expressed a desire for a smaller and more efficient government. There are too many government programs that are not working well: some programs that need to be eliminated and others which need to be redesigned to increase their effectiveness. Where I disagree strongly with both President Clinton and the Republican contract is in their promotion of the idea that the savings from reduced spending should go to cut taxes rather than slashing the budget deficit. I am not going to review the arguments for and against the various proposals to reduce expenditures, except to note that they are certainly smaller and far less specific than the promises to cut taxes. We have been down this road before with vague targets for expenditure cuts that never materialized. We would do well not to forget the missing expenditure cuts of 1981 nor the futility of the Gramm-Rudman-Hollings budget legislation of the mid-1980s.

While real progress was made with the 1990 and 1993 budget acts, much of the commitment to reduce expenditures remains unfulfilled. And, the actions taken in 1990 and 1993 were already far too small to get the job done. This Congress should remember that it will be very difficult, if not impossible, to come up with $250 billion in reduced annual outlays to match its promise to eliminate the budget deficit. It will be doubly hard if the Congress uses the first round of spending cuts to finance a tax reduction; or even worse, if it fails to reflect on full magnitude of the long-run revenue loss.

Frankly speaking, given a $250 billion federal budget deficit, if there is one thing Americans don't deserve, it's a tax cut. We would all like to pay less taxes, and tax cuts will always be politically popular; but, given the current deficit and vague promises of expenditure cuts, we cannot afford a tax reduction. The focus on tax cuts instead of deficit reduction is a serious distortion of the priorities that this Congress must address. We have to be willing to look beyond the next year or the next election and reflect on the costs of our actions for future generations. The primary concern of families with children should not be with the temporary benefits of a small tax credit, but with the long-run costs of the economic inheritance that they, as a group, are leaving to those same children: a future burdened down by continued massive increases in public debt, an astoundingly low rate of national saving, and rising interest rates that threaten to again put a home beyond the reach of many young families. This may be a tax reduction for those of us with children, but the deficit is a large tax burden on our grandchildren.

Second, the elderly already receive benefits through the budget that absorb nearly half of all program outlays. Given the extent to which those benefits exceed any past contribution, I think their case for special treatment and concessions on the tax side is particularly weak. Furthermore, from their perspective, a short-term tax cut that further endangers the financing position of the Medicare program seems a particularly poor bargain. Since the revenues from the 1993 tax increase were funneled into the Medicare trust fund, their elimination will precipitate an immediate financial crisis.

Third, I believe the proposals for business tax relief reflect an equally serious mis-diagnosis of the problem of capital formation. There is no shortage of incentives for investment in this economy, and business equipment spending, adjusted for inflation, has increased by 40 percent, three times the growth of the overall economy, in the last two years. The problem is financing. The shortage of resources in a booming economy has raised interest rates from 7.5 to 9 percent in the last year alone, and they are undoubtedly heading higher in view of the latest economic news. Americans are notorious for their low rate of private saving, but the real problem today is that two-thirds of what little private saving does occur must go to finance the budget deficit, leaving only 3 to 4 percent of the nation's income available for capital formation. To date, the increase in investment has been financed by an expansion of foreign borrowing, and the U.S. current account deficit has soared from $70 billion to $160 billion in the past year. But, when foreigners provide the financing, they also receive most of the benefits. Nor can the United States continue to borrow at present rates from the rest of the world without encountering serious financial problems. We

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have already shifted, in the brief span of one decade from the world's largest creditor nation to its largest debtor. In summary, anything the Congress should do in the near future to stimulate business investment, not financed by a matching increase in national saving, will simply be offset by the Federal Reserve as it seeks to contain inflation, or spill over into a larger deficit with the rest of the world.

Finally, the specific provisions embodied in the Republican contract are particularly threatening to the budget deficit because so many of them are back-loaded. That is, they are structured so as to make the near-term cost appear low, but it will increase rapidly in the future. For example, the tax changes embodied in the contract are estimated to cost about $42billion per year in the first five years, but a whopping $107billion per year over the next five years. This is, of course, not new: Democrats used the same gimmick of a low initial cost to introduce a variety of new entitlement plans such as Medicare and Medicaid. The President's proposal is equally guilty in this regard as it incorporated various gimmicks, such as defining children as those under 14 years of age, that call for a broadening of the tax credits in the future. The President's proposal also shares with the Republican contract a proposed expansion of Individual Retirement Accounts that would appear to be costless in the short run, but rapidly escalate in the future. The loopholes are so broad as to practically rule out any stimulus to net saving.

Current Economic Conditions

I believe that the current economic situation should have a strong influence on this Congress as it considers what to do about the fiscal situation over the next year. In the near term we are faced with an overheated economy in which the major risk has become a revival of inflation, as the expansion of demand outruns growth in the economy's productive capacity. That situation has worsened despite repeated efforts of the Federal Reserve to slow the expansion with sharp constraints on the supply of credit. Thus far, business and households have been indifferent to the higher interest rates, and the Federal Reserve probably has little choice but to raise rates again within the next few weeks. The risks here are either that inflation will again begin to accelerate (and past experience suggests that these risks are very real now that the unemployment rate has dropped below 5.5 percent), or that in its efforts to slow the expansion, the Fed will over-shoot and put the economy back into a recession. In such a situation, we can ill-afford any fiscal stimulus because it will simply translate into even higher interest rates and make the task of the Fed even more difficult. They cannot allow a further expansion of demand in an economy already at capacity output.

In fact, this Congress is faced with an absolutely ideal opportunity, a booming demand situation, to reduce the budget deficit with only benefits for the domestic economy. Two years ago we heard that deficit reduction would endanger the economic recovery and precipitate a recession. Nothing could be further from the truth. The deficit has declined by about $100 billion ($50 billion on a high-employment basis) since 1992; while the economy has boomed. Similarly, the largest effect of a reduced deficit today would be lower interest rates, higher investment, and a smaller trade deficit with the rest of the world.

I realize that Americans are very dissatisfied with the deterioration of their economic situation. More and more Americans are beginning to realize that their children probably will not live better than they do, and others are very concerned about a deterioration of their own immediate income. There are two dimensions to this problem: the stagnation of average real income growth, and a worsening of the distribution as wages fall dramatically at the bottom end of the income distribution. We are gradually becoming a dual economy of the rich and the poor rather than a society dominated by a large middle class of people in roughly similar economic circumstances.

I have tried to illustrate both of these problems with the attached figures. First, average income growth is slowing for a very simple reason -- the productivity of the average American worker is no longer growing at the rate of past decades. In fact, average take-home pay has been stagnate for over twenty years after adjusting for inflation. What little productivity growth does occur is soaked up by increased deductions for social security taxes, medical insurance and pensions. This is a dramatic change for Americans who are used to thinking that tomorrow will be better than today. The reason is not hard to identify. After nearly two decades of investing very little in the future, we should not be surprised to find that the future looks a little grim. For too long this country has been on a consumption binge and it is now beginning to feel the consequences. Real wages are no longer rising because the productivity of the average American worker is rising at a fraction of the pre-1972 rate.

This is not something that is susceptible to a quick fix -- in particular, it will not be improved by another binge of consumer spending. Americans can obtain higher incomes only by increasing their productivity; and that, in turn, can only be achieved by shifting resources from consumption, both public and private, into increased physical capital formation, greater efforts in research and development, and improvements in the education and job skills of American workers. In a sense, the solution to our economic problems is quite simple: we must increase investment across a wide range of activities. The difficult part is that increased investment requires greater saving and that can only be achieved by the sacrifice of reduced consumption. It is in that sense I believe proposals for tax cuts send precisely the wrong message about what is required to rebuild our economy.

The second problem is reflected in the sharp widening of the wage distribution since 1970, shown in figure 2. Prior to the 1970s, there was a modest tendency for wage inequality to decline over time, as those at the bottom achieved slightly higher percentage wage increases than those at the top. Since the mid-1970s, there has been a dramatic reversal and the average wage of men in the bottom fifth of the wage distribution has fallen by an astounding 25 percent, while those in the top fifth have seen increases of about 15 percent after adjusting for inflation. The cause of that dramatic reversal of relative wage trends is the major subject of current research. It appears to reflect a growing mismatch of the demand and supply of the workers of different skill levels: an increased demand for high-skilled workers versus a surplus of those at the bottom of the skill distribution. We also know that the wage differences are closely related to differences in educational attainment, and the pattern of change correlates closely with the growing public perception of a failure of the educational system serving those who do not go on to college. Again, the prescription is that we must devote more investment-type resources to improving the education and job skills of those workers who are not going to obtain a college education. By most available measures, the system still works very well for those with a college degree.

The need to scale back consumption and increase our investments in physical capital, research and development, and education stands out as the overwhelmingly most important challenge to our country. And in this regard, the need to end the fiscal dissaving of government and remove it as a drain on national saving stands out as the most important near-term goal. Elimination of the deficit is not enough -- we also need to improve the efficiency of the programs that remain and reorient them away from consumption -- but elimination of the deficit would be a major part of the solution.

The Budgetary Implications of Tax Reduction

In the attached table I have summarized the available estimates of the cost of the tax proposals. The tax reductions for families, the elderly, and business will average about $40 billion for the first five years, with the predominate portion of the cost being the child tax credit. However, the costs in future years increase dramatically to an annual revenue loss in excess of $100 billion. The sharp increase in costs is mainly due to the structure of the business tax changes. At first, the new depreciation proposal will actually raise revenues, but once it is fully implemented the costs rise dramatically. A similar large distinction between short and long-run costs is evident for the capital gains and back-loaded IRA proposals.

To put these costs in context, the latest estimates of the Congressional Budget Office show a budget deficit, exclusive of Social Security, that will be about $250 billion in FY1995 and it will rise to about $380 billion by the end of the decade. That projection already assumes no new government programs, a lower rate of health cost inflation than assumed in prior projections, and reductions in the inflation-adjusted level discretionary spending of about 3 percent annually out to 1998 as called for in the 1993 budget agreement. Since the contract exempts defense spending from further cuts, the reductions in non-defense discretionary spending would have to be about 6 percent annually just to meet the current baseline.

Let us use the year 2002 as the target date for achieving a balanced budget under the proposed amendment to the Constitution, even though it is so far in the future as to be almost meaningless as a guide for current policy. Budget outlays will have to be cut by $325 billion from the baseline to meet the objectives of the balanced-budget amendment if it is interpreted as allowing the government to continue to borrow from the social security fund, and by $430 billion if such borrowing is prohibited. The total of expenditure cuts rises to $530 billion per year if the Congress goes ahead with the full magnitude of the current tax reduction. That represents a 25 percent reduction in the projected level of total government outlays.

But that is not the end of it because the contract exempts Social Security and national defense and the government must pay interest on the public debt. These three programs will account for 52 percent of all spending. Thus, achievement of a balanced budget by the target year of 2002 would require a 50 percent reduction in the remaining programs. That strikes me as extremely unrealistic, and a promise to achieve it as even worse than Voodoo economics.

As an example, the options for painless reductions in programs such as Medicare are extremely limited. With or without a public program, health care costs rise dramatically in the later years of peoples' lives. The health care costs of persons in their sixties is 4 to 5 times that of a 20 year-old, and technological innovations which promote the extension of life are exacerbating that trend. Under current practice, a large share of the costs of medicare patients is being shifted onto those with private insurance -- Medicare is estimated to pay only about 90 percent of full hospital costs, with private patients being charged 130 percent. It is difficult to see further cost-shifting as a mechanism for offsetting future cost increases, and I detected in last year's debate no support for the rationing of health care. Of course, the government could simply cut back Medicare and limit health care to those who can afford to pay, but this is an option that many Americans will reject.

The Balanced-Budget Amendment

Unlike many other economists, I am not strongly opposed to a balance-budget amendment. I believe a public sector that constrains itself to live within its means is vital to the long term health of the economy. And at times my frustration with the Congress' unwillingness to adhere to this simple principle drives me toward proposals that would make you do it. But fundamentally, I do not think that the amendment will work. I would compare it to the 18th amendment to the

Constitution, which initiated prohibition. You cannot pass a law to make people do what the do not want to do. If Americans are not willing to accept the discipline of paying for their public services, no constitutional amendment is going to change that.

In addition, I do not understand its rationale. We shouldn't need a constitutional amendment to tell the Congress to do its job. Nor should voters need a constitutional amendment to understand the costs of sustained deficit finance. You now have a strong majority that professes support of the principle of reducing spending to the level of revenues. Why don't you do it. The idea of pushing the whole issue off until the next century seems to me to be just more temporizing, reflecting a desire of politicians to avoid the hard choice that they were sent here to make.

For nearly 200 years -- up to the 1980s -- the United States operated quite well without such an amendment. Three times we ran up large debts in wartime and fully paid them off. The public debt steadily declined from 110 percent of GDP at the end of World War II to 27 percent in 1980. Since then it has increased five-fold and doubled as a share of the GDP. What happened in the last decade that necessitates a constitutional amendment?

Nor do I have any confidence that the measure will actually pass the states. Grants-in-aid to the states currently represent about $250 billion. Given the broad exemption of payment to retirees, national defense, and net interest, grants represent 50 percent of the remaining outlays which would seem to be at the core of the proposals for expenditure reductions. Once the state legislatures do their arithmetic, they may very likely vote against the proposal.

I admit to some concern about the cyclical consequences of a rigid constitutional requirement. I would hate to see the government cutting programs and raising taxes in the midst of a recession, thus aggravating the decline. But this issue does not seem fundamental since a provision could be included for the Congress to over-ride the requirement in recessions or periods of national emergency.

In any case I am opposed to the version of the amendment as put forth by the Congressional leadership. They have used the subject of the balanced budget to introduce a completely separate issue of prohibiting future tax increases. The size of government, the question of whether it should provide a broad or narrow range of programs, is quite appropriately a subject for political debate, and the answer has depended on the circumstances of the moment. But it cannot, and should not, be settled for all time through an amendment to the Constitution. The Congress should remember that this was an election, not a revolution. The proposal raises the specter of a slew of constitutional amendments after every election as the winners try to impose their views on future generations. We have already been subjected to the unfortunate politicization of Supreme Court appointments as every interest group tries to ensure that the nominee will support their political agenda. Is the Constitution now to be subjected to the same process?

Capital Gains Taxation

Gresham's Law if often summarized as "Bad money drives out good." Apparently.,a similar law applies to tax policy as witnessed by the renewed advocacy of a reduced tax rate on capital gains income, despite the evident superiority of alternative reforms of capital income taxation. Its continuing appeal may stem from the illusory notion of a free lunch: the assertion that a reduction in the capital gains tax rate will actually raise government revenues. This issue is inherently difficult to resolve because of the problems of distinguishing between temporary and permanent responses. Initially, a tax rate reduction may raise revenues because investors can speed up or postpone realizations to take advantage of the expected rate change. Over the long-term, the preponderance of research suggests that the net effect on revenues will be significantly negative. Furthermore, a capital gains tax reduction is widely desired by large wealth holders precisely because they believe it will reduce their taxes. I think they are right.

Proposals for reform of capital income taxation should be evaluated, however, from the perspective of whether they are good for the economy. Here, the continued emphasis on reducing the tax rate on capital gains is particularly unfortunate because it is the wrong answer to a significant problem, thereby diverting attention from more fundamental solutions. The taxation of all forms of capital income is distorted because of the failure to adjust the measure of taxable income for inflation. This problem is actually most severe for forms of capital income other than capital gains, interest and dividends, and it is not resolved by simply reducing the capital gains tax rate. It could be readily fixed by indexing all forms of capital income for inflation and taxing the income as it accrues. Similar adjustments should be made for interest expenses. Under such a reform all income would be taxed equivalently, regardless of its source, eliminating a significant shortfall of the 1986 Tax Reform Act.

Instead, the focus is on restoring much of the special-interest legislation that created the real estate, and other financial market problems that burdened the U.S. economy just a few years ago. In the past, too many investments were undertaken with an eye to their tax advantages rather than in terms of their economic merits. The 1986 reforms aimed at creating a level playing field; and, while not all the distortions were eliminated, it provides a base on which to build future reforms. We should not try to go back to the old discredited system.

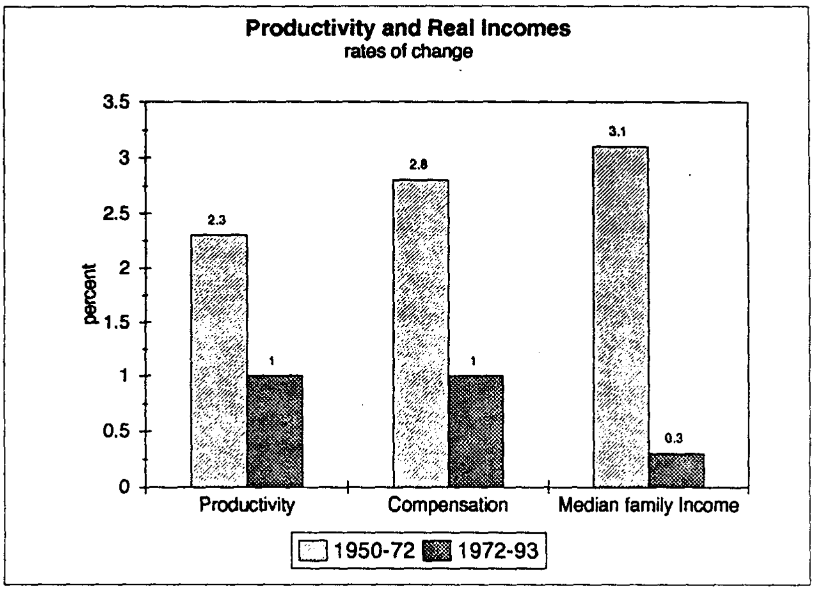
Recipients of capital gains already receive highly favorable tax treatment because they can postpone the realization of their gains and the tax is completely eluded when the assets are transferred through inheritance. Compared to other forms of income, which are taxed on an accrual basis, the effective tax on capital gains is estimated to be only about 5 percent. A reduced capital gains tax rate is also a highly distorted response to the problem raised by inflation. At low rates of inflation it is an excessive compensation, and at high rates it is not enough. Yet, if capital gains are indexed and other forms of capital income and interest expense are not, there are large opportunities for pure tax arbitrage.

Some advocates of a capital gains tax reduction promote it as a means of stimulating new economic ventures. Yet, studies have repeatedly shown that about three-quarters of the funds available for new firms are provided by investors not subject to capital gains taxation, principally pension funds. Second, the vast majority of capital gains results from activities that have nothing to do with new ventures. As a means of stimulating venture capital investments, the capital gains tax reduction is ineffective. This conclusion was amply demonstrated in a 1989 study by James Poterba of Harvard University.

The U.S. economy is suffering from a severe shortage of new capital. That reflects two problems. First, there is very little national saving to finance capital formation. The most blatant part of that problem could be resolved by simply reducing public sector dissaving.

Second, an unfortunate result of the 1986 tax reform was that it shifted the tax on capital from capital income earned by Americans to the income from capital employed in the United States, penalizing domestic investment. The capital gains tax proposal is inherently inferior as a method of reversing that situation because so much of the tax incentive would accrue to old capital and to capital gains that have little or nothing to do with new investment. A 1990 study by John Shoven of Stanford University found that a reduction of the capital gains tax to 20 percent would have a minuscule impact on the cost of capital.

There are ways to expand investment incentives without reintroducing the old tax distortions and that avoid the divisive issues of tax equity raised by the capital gains proposal. I would most favor conversion of the corporate income tax to a cash flow tax. This involved allowing businesses to deduct all investment outlays in the year in which they are made financed in part by elimination of the tax deductibility of interest payments on debt. The result would be a far more powerful incentive for investment and provide immediate funds for new firms.


Productivity and Real Incomes
rates of change
3.5
3
2.5
2
1.5
1
0.5
0
percent
2.3
1
2.8
1
3.1
0.3
Productivity
Compensation
Median family Income
1950-72
1972-93

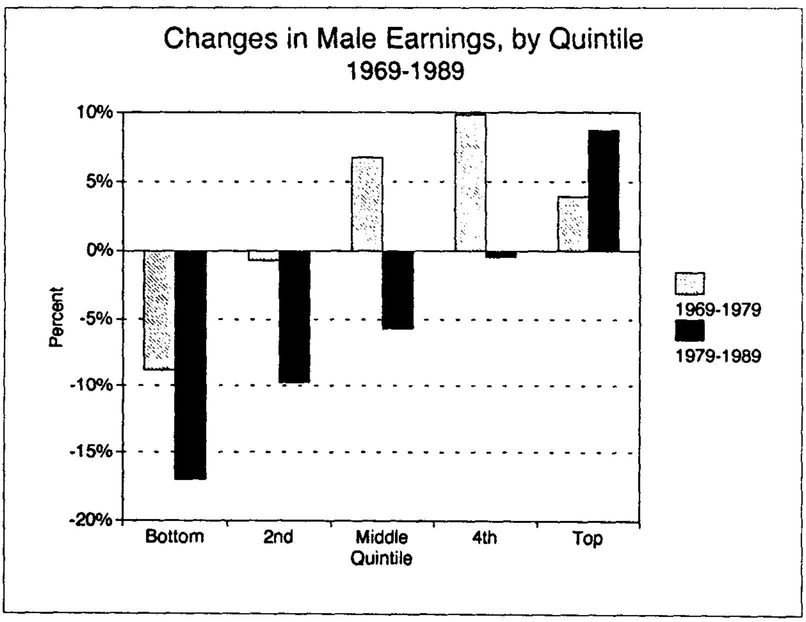

Changes in Male Earnings, by Quintile
1969-1989
10%
5%
0%
-5%
-10%
-15%
-20%
Percent
Bottom
2nd
Middle
Quintile
4th
Top
1969-1979
1979-1989

Table 1. Identifiable Costs of the Republican Contract (in billions).

	fiscal years	
	1995-2000	2001-2005
Families		
$500 per child tax credit for families with AGI < $200,000	-124.1	-164.4
Refundable $5,000 tax credit for adoption expenses	-1.4	-1.9
Refundable $500 tax credit for eldercare expenses	-1.2	-1.4
Reduce marriage penalty	-9.0	-10.0
Back-loaded IRA	+5.0	-22.7
subtotal	*-130.7*	*-200.4*
Senior Citizens		
Raise social security earnings limit to $30,000	-6.5	-17.0
Phase-in repeal of new SS thresholds (85%) enacted in 1993	-15.0	-33.5
Long-term care tax incentives	-6.0	-9.7
subtotal	*-27.5*	*-60.2*
Business		
50% exclusion for indexed capital gains	-60.9	-122.2
Expand depreciation allowance	18.4	138.8
Small business tax reductions	-11.3	-15.4
subtotal	*-53.8*	*-276.4*
Total	**-211.9**	**-537.0**
Annual Average	**-42.4**	**-107.4**
Percent of GDP	**0.5**	**1.0**

Source: Treasury staff estimates as published by Bureau of National Affairs; plus subsequent revisions.

Table 2. Deficit Reduction Targets
(in billions)

	fiscal years	
	1996	2002
Overall Expenditures	1625	2200
Revenues	1420	1880
Budget Deficit:	-205	-320
operating fund	-280	-430
social security	75	110
Tax reductions		-100
Required reductions:		
Overall balance		-420
Operating budget balance		-530
Exclusions:		
National Defense	270	325
Social Security	350	480
Net Interest	235	345
subtotal	***855***	***1150***
Targeted outlays	**770**	**1050**
Medicare	195	345
Medicaid	100	180
Nondefense discretionary	280	300
Other entitlements	195	225
Deficit target (operating budget), percent of:		
Total outlays		24%
Targeted outlays		51%

Source: CBO baseline projections.

Chairman ARCHER. Thank you, Dr. Bosworth.

I thank each member of the panel. I am going to forgo my questioning at this point and yield to the ranking Democrat of the committee.

Mr. GIBBONS. Dr. Bosworth, I agree with you 100 percent, but I think we are pandering to our constituents when we promise them tax cuts and we have still got this huge budget deficit. We have got almost full employment. Really, I think we probably reached the full employment stage by now. We are reaching factory capacity or industrial capacity and we are talking about pumping more money into the consumer stream. That is, in my opinion, just totally ridiculous.

And so I agree that the first priority of this Congress should be at this time to not only continue reducing the budget deficit but to accelerate the reduction of budget deficit. That to me would seem to be the best economic medicine that we can take.

What do you think of that?

Mr. BOSKIN. I agree about reducing expenditures, particularly in the near term. I think you should be extremely nervous about the economic situation and the pressures that are being placed on the Federal Reserve.

We are at a full utilization of our resources. The biggest near term threat to this economy right now is inflation. And in view of the latest economic news, I think you are almost guaranteed that the next meeting of the Federal Reserve will initiate another major increase in special rates.

If this Congress should in any way at all inject additional fiscal stimulus on top of an already overheated economy, the only possible outcome could be higher rates of interest. But there is, as interest rates rachet up very rapidly, a major risk, because of the lags in the economy's response to those higher interest rates, of overreacting. That has been our history. Monetary restraint trying to stop the process and then it overshoots and we plunge into recession.

Mr. BOSWORTH. I think we run a very major risk right now that if we don't have a very responsible fiscal and monetary policy, we are going to miss this opportunity to slow things down and achieve a soft landing. So I think it is very important that the budget deficit shrink dramatically over the next couple of years. You will never have a better opportunity to cut the deficit than right now in the face of accelerating economic demands. There is no cost to the economy of deficit reduction now, only benefits.

Mr. GIBBONS. Yesterday the Assistant Secretary of the Treasury estimated that with the Contract plus the balanced budget amendment by the year 2000 this Congress must cut spending by $1.6 trillion. Suppose this Congress procrastinated, as it usually does, and didn't put us on that drastic reduction rate. What would happen to the economy as we come closer to the year 2000?

Mr. BOSWORTH. Right now of all private saving that occurs in this country, two-thirds of it goes to finance the deficit. And as you postpone action and the public debt mounts, and the increased interest costs get channeled back into the expenditure side, the only outcome of that is to further draw more potential savings away from business capital formation and residential construction.

I think in particular what will happen to the country is we will just accelerate the process of selling everything off to foreigners. We will have an ever larger current account deficit with other countries and try to borrow even more. But you cannot keep doing that forever. There will come a time that the rest of the world will not be willing to make the loan to the United States to finance our consumption.

You have to look forward to that, maybe not in my lifetime, but certainly in my children's lifetime, that this sort of process of running down the wealth of prior generations to finance our consumption just can't continue, and the longer we put off action, the harder it is going to be to get things back in balance again.

Mr. GIBBONS. Mr. Chairman, this is an excellent panel. My time has expired, but I would like to come back after everyone has had a chance to examine.

Chairman ARCHER. Mr. Bunning.

Mr. BUNNING. Thank you Mr. Chairman. I would like to ask just the general panel one question. We talked about welfare, about the problems with welfare and about our Tax Code, as such, and the complications of our Tax Code. If you had a choice to do one thing in the Tax Code to make it more family friendly, what would you do?

Ms. O'BEIRNE. Ultimately, beyond the parameters set down by the Contract, I think we have to move toward a family friendly flat tax. I think Mr. Armey's proposal begins to look like that.

We have to recognize, notwithstanding all of our concern for the family and all of our rhetoric about strengthening families, families with children are the lowest per capita income group in America. Washington normally forgets about these families. The median income family with two children is paying 40 percent of their income to government, Federal, State, and local taxes. They are being crushed. Family time is being crushed. It was never more important to spend time with our children in this hostile culture, and they are not able to because of the demands government places on families, a demand unheard of a generation ago.

So when people wonder how come when my parents were our age they owned a home, were able to save a little bit, mothers with preschoolers didn't have to work if they chose not to—why has that changed so dramatically?. Look no further than the tax burden that has been inadvertently placed on families.

Mr. BUNNING. You are saying that a flat tax would be family friendly. You wouldn't say to convert the Tax Code to a different type of tax rather than income-based to a consumption-based tax. I am trying to find out what each of you think should be the number one priority.

Ms. O'BEIRNE. I am a fan of the $500-per-child tax credit because it begins redressing this problem that specifically families with children face.

Mr. BOSKIN. I am not an expert on some of these social issues, but I have written on them and I have recognized one particular problem, which is we know from various studies that part of the problem is that second earners in families wind up paying very high marginal tax rates. Historically, perhaps it was the wife that was thought of as the second earner, but that is equalizing as we move through time.

The second earner of the family on their first dollar of earnings pays the marginal tax rate of the last dollar of earnings of the first earner. They may come into the labor force and on their first dollar they are paying combined 30, 40 percent of income. If there was a move to shifting from an income, family pooled income-based tax to a consumed income tax or a transactions-based consumption tax, some of those kinds of issues could be reduced.

There are other issues, but I believe the very high tax burdens and marginal tax rates on second earners of families who are very responsive to them is a serious problem.

Mr. NOVAK. The highest tax we are paying now is not a material financial one, it is a behavioral tax. This comes from the sentence of Senator Moynihan that my colleague quoted awhile ago. The great difference in poverty in the last 30 years is how much of it is now caused by behavior, by behavior which has, if it has not been produced by our attempt to be compassionate and to help, at least has not been checked by that.

When I spoke in favor of the war on poverty or tried to argue for it 30 years ago, I didn't predict a 600-percent increase in illegitimacy or a 700-percent increase in crime. The American public cannot carry that load. That is the problem we have to begin to address. A cure that will not be induced only by tax policy.

Mr. BOSWORTH. I think that we have done some things like the earned income tax credit that seem to me go in the right direction. I think one central problem with the current welfare system is on tax and also the way the expenditure programs work. The incentives to try to earn a dollar once you are on welfare are about zero because for every dollar you earn in wages, you get a reduction in benefits.

Now, the problem is not just on the tax side. It is also on the expenditure side where we phase these programs out as income rises. I think closer consideration of the integration of the tax system on low-income people together with the benefit proposals—every separate program has its own sort of, in effect, marginal tax.

The biggest one of all is the poor people who the best opportunity they have to get a job is a job that almost never, never provides health care. So the biggest barrier to getting off welfare is if you are on welfare, you got Medicaid for your children. You get off it and get a job, almost never are those workers going to have access to health care.

So I think we have a set of screwy marginal incentives to get people back out working instead of taking public welfare. It is not just the tax side of it. It is also the way the benefit programs work.

Chairman ARCHER. The gentleman's time has expired. The gentlelady from Washington, Ms. Dunn, will inquire.

Ms. DUNN. Thank you, Mr. Chairman. I am new to this whole discussion being new on Ways and Means and on the subcommittee that will deal with welfare reform. I have noticed the discussion between static scoring and dynamic scoring. I wonder if you could comment on why this seems to be so badly misunderstood between political parties, but just in general, and what direction you think we should take to be as realistic as possible as we project what is going to happen as a result of tax cuts?

Mr. NOVAK. Even though I don't speak as an economist, may I make a point on that? When Mr. Bosworth spoke a moment ago about incentives for behavior, that is making the same point. If you structure the benefits in welfare in a certain way without paying any attention to what the behavior of the recipient is, which is what we tried to do in the sixties, that is different from what we did in the thirties on welfare. If you let go of the incentive side of the picture, you miss something very important.

I will yield to those who can talk to the economics.

Mr. BOSKIN. Currently the revenue estimators, Joint Tax Committee, do make some estimate of behavioral responses. For example, if tax rates go up, they will estimate how much more tax-exempt bonds will be purchased and incorporate that. If there is a change in capital gains rates, they estimate whether there will be some induced realizations and how many.

When I was in the Bush administration, our Treasury scored our 30-percent capital gains rate reduction proposal as gaining $12 billion and the JTC as losing $12 billion. That is an important difference, but even the JTC had sizable induced realizations.

They don't take into effect the effects of stronger or weaker economic growth and rising incomes on corporate and personal payroll tax revenue.

If there were infinite resources and we had a precise model that could capture that, we should do that. There was a joint hearing of the Budget Committee yesterday, at which I testified, but I think it was the unanimous view that, if possible, we ought to be doing this. There are practical problems and practical considerations, but I do believe that progress can be made in a prudent serious way, consistent with getting more accurate information provided to you as decisionmakers that is not, as some charge, cooking the books and would not, and I would not use exactly the words Barry Bosworth did, but he is correct; we need to make further progress on deficit reduction and we don't want to use this as an excuse not to cut spending or reduce the deficit.

But I think progress can be made. I would ask that all the testimony be forwarded to you, and I think the Joint Tax Committee is going to try to evaluate what can be done in that regard.

Ms. O'BEIRNE. Yesterday I noticed the committee talked about a parallel, dynamic versus static modeling when the administration makes the absolutely ridiculous claim that 5 million poor children will be denied benefits under the Contract version of welfare reform as though nobody will ever change their behavior as a result of some very profound changes. This is provably untrue.

The American low-income population has profoundly changed their behavior over the last 25 years in response to welfare incentives. Teen pregnancy is not a new phenomena, but people used to get married because they had a need to. There wasn't a government moving in pretending to take the place of a husband and father. People make rational decisions.

So while the administration is denying that anybody would ever change their behavior based on some new powerful incentives, they also recognize that there is a problem of welfare migration between

States, that a high benefit State like Wisconsin has a problem being a magnet is the word the Secretary used, attracting people from Texas.

Isn't that a recognition that people make choices and that there is a dynamic within the welfare population responding to very powerful government incentives?

Mr. BOSWORTH. I basically agree with Michael that in principle I think we would like to take account of the dynamic consequences of government actions. We do adjust for people's behavior up to the point where it changes GDP. I think the concerns are there is a lot of uncertainty about precisely what the numbers are, one.

From a Democratic point of view, I guess, you might say they are alarmed by this suggestion because they are worried that a supply side extremist-type approach may come back and advocate that the whole problem will go away, and the tax cut will pay for itself.

On the Conservative side, I think there is an equal concern about some of the rhetoric of others that every benefit program pays for itself. For example, if I would just improve the health of children, they will be more productive in the future, they will contribute more to society, and it pays for itself.

It begins to sound like a gimmick that you don't have to pay for anything. It is the discipline that people worry that you would lose. Dynamic scoring is fine if it is done in a pragmatic, hardnosed manner.

One suggestion has been in fact that maybe the Congress should try to go outside to some sort of neutral group that might be willing to put together some methods of doing this, say, for example, the American Economic Association, someone who doesn't necessarily have a stake in the outcome.

But I would warn you, even among academics there is a wide disagreement on exactly how big these incentive effects will be. We don't have a lot of information on which to base the estimates and we are not allowed to undertake a lot of experimentation with people's lives just to see what would happen.

Chairman ARCHER. The gentlelady's time has expired. I would like to piggyback on that last comment Dr. Bosworth. If all the economists in the country believed there would be a positive macroeconomic effect on the GDP as a result of a tax change but disagreed as to magnitude—and that would probably be the case—would it not be appropriate for us to take the most conservative view and use that for estimating purposes?

For example, if one end of the spectrum was a one-tenth of 1 percent increase in the GDP and the other was a full 1 percent increase in the GDP, would it not be credible, valid, supportable to take the one-tenth of 1 percent as the basis for your estimating?

Mr. BOSWORTH. I think that sort of conservative approach is a positive way to think about moving maybe ahead with it. I would warn that it is not necessarily always true that the smallest response is the most correct response.

You might be able to do better than that and try to get some extant consensus about a more midpoint estimate. But the idea of looking at the range and following a conservative approach, I think, is one way you could go.

Chairman ARCHER. I have frequently been called a Conservative, so I would identify with that kind of approach. Today we are using a totally static model in which no changes are reflected as a result of a massive change in the Tax Code.

No change will be reflected insofar as its effects on the macroeconomy. It seems we are moving away from accuracy rather than moving toward accuracy by continuing to adhere to what I believe is an anachronistic approach, particularly with regard to computer modeling, which we didn't have when we first began to do this. I wanted to piggyback further questioning with the indulgence of the committee.

Mr. Levin will inquire.

Mr. LEVIN. Mr. Chairman, if we do that regarding tax proposals, then I suggest that we do the same on the benefit side; I am worried about opening that door. Let me ask Michael Boskin, take 1 minute because I want to ask Ms. O'Beirne some questions—in 1 minute or so tell me how much you agree or disagree with the thrust of Barry Bosworth's testimony.

Mr. BOSKIN. I believe deficit reduction is important. I don't believe it is the sole problem confronting the country. I wouldn't agree with some of the adjectives he used or hyperbole, and I would put the deficit in the broader context of the Nation's savings rate. He did that and then went on to focus on deficit reduction.

I think by focusing on deficit reduction outside that context, the Congress and the President last year made a bad mistake. I think they raised taxes in a manner that hit private saving very hard. I think that is a circular thing to do.

If the reason we want to reduce the budget deficit is to reduce its drain on the available supply of private saving available to finance productivity enhancing investment, the last thing you want to do is reduce the deficit in a manner that reduces private saving.

And the big increases in marginal tax rates and the limits on 401(k)s hit households in their peak earning and saving years very hard, hit wealthy people with a higher propensity to save, and hit small business, 80 percent of which are unincorporated and 42 percent of corporations are subchapter S corporations, particularly hard. The personal savings rate went down $60 billion a year. Nobody knows whether that is 20 percent because of taxes or 80 percent, but in the broader context of a higher national savings rate, I think we both need to reduce public borrowing and do it in a way that does not harm private-sector saving but raises private saving.

Mr. LEVIN. Dr. Bosworth, take a couple of seconds to respond and leave me a little time to ask Ms. O'Beirne a question.

Mr. BOSWORTH. I agree with both of those objectives. I would like to eliminate public-sector dissaving and would like to increase public-sector saving. We will add to national saving when we reduce the budget deficit. The private savings rate in the United States has basically been stable for a long period of time, has declined in the last 5 years, not with any particular timing of tax changes.

I think we should go for the sure thing, one positive way you will get 95 percent of all economists to agree—you want to increase national saving in this country, get the public sector to quit dissaving. That works. Then you say what should I do about private saving? My profession is all over the map. We don't agree on a thing about how to stimulate private savings and what will work and what won't work.

Mr. LEVIN. Maybe someone else will pick that up because I want to ask Ms. O'Beirne, I hope one of my colleagues, because I think we don't have enough debate among panelists when we hear the testimony. It makes the hearings static. You say $324 billion spent on welfare. That figure includes, just so we are all clear, because I very much agree with you about breaking the cycle of dependency, that includes Head Start, does it not?

Ms. O'BEIRNE. Yes.

Mr. LEVIN. Pell grants?

Ms. O'BEIRNE. It is the Congressional Research Service's all means tested expenditures.

Mr. LEVIN. So when you say welfare, you are talking about Head Start, Pell grants, title I, JTPA programs, the JOBS programs, summer youth programs—are you talking about Medicaid?

Ms. O'BEIRNE. Medicaid yes, not Medicare.

Mr. LEVIN. Medicare low income you are talking about. So no one should think when you talk about welfare spending that we are talking primarily about AFDC. It includes all of the low-income-related programs?

Ms. O'BEIRNE. Yes.

Mr. LEVIN. Do you think each and every one of these has exacerbated behavioral poverty? For example, Head Start. Has that, do you think, exacerbated behavioral poverty?

Ms. O'BEIRNE. The general point we have to remember is virtually every one of these programs has as its purpose helping in some way to alleviate poverty in America. It comes out to $8,000 per poor person in overall spending.

Do they work at cross-purposes? Yes. Their benefit levels, rules, and regulations governing them frustrate the States, but these dollars have been appropriated by Congress trying to lick poverty. And they do operate as a package.

The typical woman on AFDC gets benefits from 10 to 12 programs. So with that population specifically in mind, we are not talking specifically about AFDC, food stamps, and Medicaid and housing. It winds up being roughly $15,000 per year on the condition that you have a child and not marry an employed man and not work. It is very much a system that young women have been trapped in.

Some of these programs are more destructive than others, but the overriding point is to remind the American public in their generosity and frustration with this problem, we are now spending over $300 billion a year, and I venture to say that far from getting our money's worth, they are now convinced that much of the spending has been destructive.

Chairman ARCHER. The gentleman's time has expired. Mr. Collins will inquire.

Mr. COLLINS. Thank you, Mr. Chairman. Ms. O'Beirne, I wanted to ask you about the earned income tax credit. I believe that is one of the entitlements of the $300-some billion that you referred to.

When the earned income tax credit was implemented in 1975, it had a twofold purpose, to cover the Social Security taxes for low income that were being removed from their paychecks, and the other was to encourage people to work and to get off of welfare. Of course, the Social Security tax coverage, that has happened, but, in your opinion, has the earned income tax credit actually removed people from the welfare rolls?

Ms. O'BEIRNE. We have always broadly supported the earned income tax credit as a better use of welfare dollars because, as you noted, it subsidizes work rather than nonwork. I guess as recently as last year it was broadly expanded.

I would be delighted to get back to you with an analysis my colleague has done on whether or not we have begun yet to see the effects of that, but, as a general proposition, we have argued that it is better to subsidize work and marriage than to subsidize illegitimacy and nonwork.

One problem with overly fixating on that half of the equation to make work more attractive is that we have created a very seductive, attractive system that subsidizes destructive behavior, and then we spin our wheels trying to figure out how to tempt people out of the first mess we have created.

The emphasis was very much in 1987 and 1988 on trying to address that second half, and we did, child care benefits for 1 full year after you leave welfare, health coverage for 1 full year, trying to tempt people off. This round of welfare reform, hopefully our final from Washington because the Governors should be full partners and from here on in States should take a bigger role, has got to focus, I think, in a much more dramatic way on the first half of the equation and begin to make welfare unavailable for very young mothers with children. That is a child welfare problem. And most unattractive for able-bodied people who would rather be on welfare than work.

I would be happy to share with you any research my colleague has on whether or not we have seen the beneficial effects that we would like to.

Mr. COLLINS. It would be interesting to see your study because a study I have seen indicates that the welfare portion of it has not really worked. People have a tendency to earn up to a certain level and then they begin to not show up for work as often because they know they have peaked out as far as benefits received from the earned income tax credit.

Another question would be should we look at the formula for the earned income tax credit as to how we reward work similar to how we provide bonuses in the private sector for work, and should we look at a cap for earnings that it is applied to?

One question on block grants to States which you seem to support very much. Governor Miller of Georgia made a comment to me 3 or 4 weeks ago that if you will just send me the funds, even if you send me less, I will handle the welfare reform.

Does there seem to be a consensus among Governors on this issue?

Ms. O'BEIRNE. Yes. Your own Governor reflects broadly the experience I have had talking to Governors as recently as last month in Williamsburg. They appear to be totally convinced that the system designed in Washington, controlled by Washington, details of which are dictated by Washington, is a very costly proposition at the State level and that they could serve in at least as thoroughly, and given their impulse to design different incentive systems far more beneficially, the same population at much less cost than Washington.

You don't talk to a State welfare director without hearing this frustration and there seems to be a critical mass of the Governors who are convinced they can do a better job at a cheaper price.

Mr. COLLINS. Thank you very much. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman and thank the panelists for a wealth of information you have provided us today. I want to focus my questions initially on my former colleague, Michael Boskin. I appreciate your coming here. I love your bucket analogy, you end up with 60 or 70 cents, which is less than 50 percent of where you start in terms of private-sector cost on taxes, and that is a point that I think needs to be reinforced.

You talked about a comprehensive overhaul of the Tax Code. I think our chairman would be sympathetic. I am not sure if you support the same comprehensive overhaul, but I think that is something that this committee, based on what the Chairman has said, is interested in taking up in the future. Focusing on the capital gains issue and the issue of saving, I think, there is evidence based on what happened in 1986 that this will be good for the economy and will increase rather than reduce revenue.

A few questions that I am getting as I deal with the capital gains issue or by way of devil's advocate. Why shouldn't interest income be indexed? You said not indexing capital gains was the same thing as confiscating wealth. What is the distinction to be made between an investment in a CD or a money market fund and assets that would receive the capital gains treatment?

Mr. BOSKIN. In a world where we were able to do all of it, there would be a case for fully indexing for everything, but it would help reduce the constituency to keep inflation low if everything were indexed. In the mideighties tax reform, the Treasury looked at various ways to try to index interest payments and interest deductions, and it is not an easy thing, but in principle it should be done.

The important thing is if you have debt finance and people are deducting nominal interest, you have to be careful you don't wind up creating vehicles for a big, new round of tax shelters if you have much more rapid depreciation and capital gains. My view is that the case is most direct for capital gains because for a larger fraction of assets, there wouldn't necessarily be a corresponding adjustment in nominal interest rates to compensate the people for the risk of inflation or the actual inflation as compared to indexing all interest income, which I think would have that risk.

In an ideal income tax, you would do that, but we are a long way from that and it is one reason the Chairman pointed out it is awfully complicated to get an ideal income tax.

Mr. PORTMAN. Let me ask as a followup, to avoid any of the possible tax shelters or other economic decisionmaking that might be motivated by this kind of a tax change, would you prefer to just see individual rates lowered overall, marginal rates reduced if you had a choice between capital gains and a rate decrease?

Mr. BOSKIN. I think we have a serious problem in capital gains because the amount of rate reduction if it was spread across the board would be small, and I think would not have as beneficial an impact, as big a bang for the buck. However, as a general proposition, when you are talking about changes in the income tax, the lower the rates, the better.

Mr. PORTMAN. I have a question for Dr. Bosworth. Do you see any distinction between the homes that people live in, not second homes, but first homes and other assets? Doesn't it make sense to at least apply the capital gains differential to private residences which are not purchased as an investment and where people live in them. It does have the effect of keeping people in homes longer than they would like to be. Would that be an appropriate carve-out at least?

Mr. BOSWORTH. No. When it comes to residences, I think the basis for capital gains treatment is weakest because housing is already extremely favored under the tax system as it presently is, because people do not have to pay taxes on the income that you implicitly get from owning instead of renting your home.

I would worry with any sort of partial feature of reform of capital gains, that the issue that Michael Boskin mentioned as sort of an aside is absolutely central, which is that you can arbitrage the system and play games. What happened in the late eighties in real estate is a good example. If you could take interest deductions that are a nominal rate and put it into an asset in which you get an inflation adjustment, you just play games with the tax system, and it is very dangerous.

We have seen these collapses in our country and in other countries. Capital gains income needs reform. It is a serious distortion to include an inflation component in the definition of capital income. But partial measures will make the situation worse, and I think the most important one in fact is to deal with the interest, not with the capital gains.

Capital gains you get some adjustment, you can postpone, and a lot of people never end up paying the capital gains because you hang onto it for your whole life and borrow against it. The people who can't avoid it are low-income people who have interest income on their savings accounts and they get charged the inflation.

Chairman ARCHER. The gentleman's time has expired. Dr. McDermott.

Mr. MCDERMOTT. I would like to debate with the panel, but first I would like to point out some things about disincentives. Real wages have not increased since 1965, in fact, they have gone down. Less and less workers have benefit packages, pensions or health care benefits, and, if they do, they are less generous. Fifty percent of the people without benefits today are working full time and the employment market is going increasingly toward temporary workers.

Ms. O'Beirne, it seems you assume that poor people are stupid. They look at the incentives and say it is better to stay on welfare than to get a job where I can't pay for day care, I can't pay for health care, and I ultimately have no pension. There are some real incentive problems in society.

You said the mother must identify the father of the child in order to receive AFDC or food stamps with few exceptions for hardship cases. That is your testimony. Let's say she identifies that father. Should she at that point be eligible for benefits?

Ms. O'BEIRNE. The current law, as you know, mandates that in order to qualify for AFDC, you have to fully cooperate with child support enforcement people. It is broadly ignored.

Mr. MCDERMOTT. If she identifies him, she says this is the father, she should be eligible for benefits or should she not? Does it depend on whether the State follows up and establishes it and gets the money from the father? She says this is the father. Is that sufficient for her?

Ms. O'BEIRNE. That is the status quo, and that has been insufficient. We have lavishly spent on child support enforcement——

Mr. MCDERMOTT. You are saying that a woman ought to be penalized because the State doesn't follow up on their responsibility to establish paternity?

Ms. O'BEIRNE. I am saying that experience teaches us there is a superficial cooperation level. "It was Michael Kelly, he lives on Third Street, I haven't seen him in 4 months," because the incentive is not to give his name to the child support enforcement people or there is a serious effort to cooperate and identify the absent father. At the moment, there is no real incentive to cooperate. I can give any name and if nobody can find him in a phonebook, that is the end of the trail.

Mr. MCDERMOTT. You are assuming that the problem with establishing paternity has been that the women have sort of picked a name out of the air and given it, and that was sufficient to meet this qualification to get welfare.

Ms. O'BEIRNE. There have been and it is a frustration of this committee a number of problems with the program. Many States don't take it particularly seriously, notwithstanding the incentives the Federal Government has provided to have them do so. Despite the $50 passthrough, many women do not take the responsibility seriously. It has been one of our thorniest problems trying to truly identify absent fathers.

Mr. MCDERMOTT. Let me go a step further. Now we have this child and the mother has given the name and the State has been lax and therefore the child isn't fed. Currently, when children are abused, they go into the child protective services, they become a ward of the State. Should the child be taken away from the mother because she was unable to feed that child? In your opinion, is that a part of the welfare reform that we should put in?

Ms. O'BEIRNE. That is not what I am advocating.

Mr. MCDERMOTT. What are you saying these grants to the State are going to be? I sat and read that and I guess you could contract out to the NRA to go out and perform shotgun marriages so that we would have everybody married.

I don't know what these programs are going to do when you have the child on the Earth hungry and not being cared for and the State has failed in their position, what happens to the kid if you are not going to take the kid away and put him in foster care?

In the State of Washington, welfare is $13,000, the care of a kid in an institution is $36,000. Now, you tell me if that is a cost savings.

Ms. O'BEIRNE. That is not what I am advocating. I advocate a system that doesn't destroy low-income kids who have been victims of the system for the past 25 years. Young women have to be responsible, and I think they are perfectly rational, and a young man who is not a good husband and father should no longer be in the purview of a young woman. If we make her more dependent upon him, it matters who fathers your baby.

It doesn't matter nowadays who fathers the baby. The child support enforcement system has been 15 years of frustration with sometimes States and counties not taking it seriously, and where they do, there are good results, and sometimes young mothers themselves not taking responsibility for identifying him, families have to become more engaged. These young women live in families who have to take a greater role, along with churches and communities.

Mr. MCDERMOTT. But it is not happening and the children still exist. You can sit here and say that you want the government to pick out the perfect marriage partner for these women, which seems to me terribly intrusive for people like you who don't believe the government should do anything——

Ms. O'BEIRNE. Which is why that is not what I am advocating.

Mr. MCDERMOTT. So then how do you make this happen when the divorce rate is that one out of two marriages ends in divorce, you have increasing illegitimacy, not only in lower classes, but also in the middle class. How do you deal with that when you have the kid that is not fed? You have to deal with that some way.

Ms. O'BEIRNE. In the name——

Chairman ARCHER. I am afraid the gentleman is going to have to pursue this at another time. The gentleman's time has expired.

The Chair recognizes Mr. English to inquire.

Mr. ENGLISH. Thank you, Mr. Chairman.

Ms. O'Beirne, I would like to pursue some of the things that I think you touched on in response to Mr. Collins' question having to do with State flexibility. I think we are familiar with Justice Brandeis' famous quote about States being laboratories of social policy.

I wonder where in your level of priorities of welfare reform is State flexibility as something to be included in a welfare reform bill, and do you anticipate that State flexibility will generate genuine policy innovation at the State level?

Ms. O'BEIRNE. It should be front and center in any Federal reform. It was a small piece of it in 1986, in 1987 when we last did this. It should be front and center this time, first of all because the Federal system has so profoundly failed.

There are energetic committed Governors who are ready, willing, and able to take on responsibility and there is so much we don't know because this one-size-fits-all policy we have been pursuing has not permitted much innovation. There is plenty we have to know and, at the moment, we have to look at, well, a county in Ohio ran a good program some years ago, and we have learned a lot from Governor Tommy Thompson, who fought with Washington in order to get the sort of flexibility he needs.

If we got to the position where there were 50 different systems and, once it is at the State level, counties trying different approaches, welfare debates in Washington would be better informed, and I am convinced that low-income Americans would be far better served.

Mr. ENGLISH. Thank you. Yesterday in our hearings Secretary Shalala spent a good deal of time commenting on the legislation pending before this committee and also advocating the Clinton proposal of last year.

I know your organization has done an analysis of the Clinton administration's proposal. Could you highlight what you think are your major reactions to it?

Ms. O'BEIRNE. I would be delighted to briefly and will share with committee members copies of a paper published by the Heritage Foundation not long ago on the Clinton proposal.

[The following was subsequently received:]

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HOW CLINTON'S BILL EXTENDS WELFARE AS WE KNOW IT

INTRODUCTION

Americans are alarmed by the growth and effects of welfare. They correctly perceive the current system to be an extraordinarily expensive debacle which destroys the lives of those it is intended to help. And by promoting illegitimacy and undermining the family, they see welfare as threatening the foundation of society.

Campaigning for President, Bill Clinton acknowledged that the War on Poverty had failed. He promised to "end welfare." Now, more than two years later, President Clinton has unveiled the details of his "end" to welfare. But far from reform, the President's plan, called the Work and Responsibility Act of 1994, is simply a public relations facade intended to forestall real criticism and change. When the masquerade of "reform" is removed, the plan represents little more than a continuing rapid expansion of the current destructive system.

The cosmetic nature of the Clinton plan should not come as a surprise. Periodic sham reform has become the lifeblood of the welfare system. With each such reform the system grows larger and more expensive. Just a few years ago, Congress declared it had "ended welfare" with the Family Support Act of 1988. This act was touted in the press as a dramatic change in the foundations of the welfare state. In describing the 1988 act, Senator Daniel Patrick Moynihan (D-NY), its chief sponsor, declared:

> We're going to turn the welfare program upside down. We're going to take a payments program with a minor emphasis on jobs, and create a jobs program in which the income supplement is assumed to be temporary.[1]

1 Martin Tolchin, "Welfare Revision: Moynihan Seeking to Stand System on Its Head," *The New York Times*, June 12, 1988.

The next day he added:

> This is the first time ever we're going to take a [income] maintenance program with a slight work component and turn it around to be a job program with income supplements until you're on your own.[2]

And later he declared:

> For the first time in [welfare's] half-century existence, the U.S. Senate has moved to an entire redefinition and overhaul of what we've come to know as our welfare system...[under the revised system] welfare will no longer be a permanent or extended condition.[3]

For good measure, Senator Howard Metzenbaum (D-OH) declared, "[t]his bill makes a dramatic step forward to encourage the stability of the family."[4]

At the time, conservatives said the act was a resounding lie, in that it did none of these things. They were right. The 1988 legislation did nothing to overhaul the welfare system. It did not introduce real work requirements: today, seven years after its passage, less than one percent of adult AFDC recipients are required to work. It did not curb the growth of welfare spending: welfare rolls and costs have exploded at near-record rates. And it did not help to stabilize the low-income family: illegitimacy has soared.[5]

Nor was the welfare system starved for funds after 1988. In fact, aggregate welfare spending has increased at a near-record rate of 10 percent per year in the last five years. In the same period, Congress deliberately expanded eligibility for programs such as Medicaid. Few funds were provided for workfare, however, because the liberal Congress is privately opposed to it.

Carbon Copy. Clinton's present welfare plan is a carbon copy of the welfare reform fraud of 1988. The rhetoric and description of Clinton's proposal is virtually indistinguishable from the earlier "historic" legislation. As with the 1988 act, Clinton's proposal does not reform welfare but merely creates the appearance of reform, blunting public disaffection with welfare while permitting the continuous rapid expansion of the current system.

2 Moynihan on the McNeil-Lehrer NewsHour June 13, 1988.

3 *St. Petersburg Times*, September 30, 1988.

4 *The Congressional Record*, June 13, 1988, p. 7661.

5 The conventional explanation for the failure of the 1988 Family Support Act is that it did not receive enough funding. This is untrue. The 1988 act has operated exactly as designed by Congress. The crucial fact is that the act required virtually no welfare recipients to work, and only a tiny fraction even to search for work. Most states have executed the requirements of the 1988 act faithfully; but these requirements were designed to affect less than a tenth of the AFDC caseload. Furthermore, even the minimal JOBS participation requirements in the 1988 act were opposed by Senator Moynihan.

Deception is the core of Clinton's plan. The President claims his bill ends welfare after two years. It does not. It does not even require a significant number of recipients who have been on welfare for over two years to participate in government make-work jobs in exchange for future benefits.

Specifically, the bill:

- ✗ **Does not establish time limits on welfare.** Despite talk of "two years and you are out," the bill merely places a few beneficiaries in government make-work jobs—misnamed the "WORK" program—while they remain on welfare.
- ✗ **Requires only 7 percent of the welfare population to enroll in the WORK program by 1999.** The bill is deliberately designed to affect only a small fraction of the welfare caseload.
- ✗ **Requires those in the WORK program to work for only 15 hours per week.** With the full value of their continuing welfare benefits included, these individuals will receive an effective wage rate of $16 per hour.
- ✗ **Phases out work requirements in the AFDC-UP program which can substantially reduce the caseload.**
- ✗ **Allocates $4,000 per year merely to cover the administrative overhead for each participant in the WORK program.** Adding in the cost of continuing welfare benefits and other expenditures, the total taxpayer cost of maintaining a typical household in the WORK program is likely to be around $20,000 per year.
- ✗ **Is not deficit neutral.** The bill contains many costly expansions of welfare programs. Taking advantage of a loophole in the budget rules, much of this new spending does not appear in the standard budget projections. This allows the Administration to claim its plan is deficit neutral when it is not.

While the bill's time limits and work requirements are a sham, even worse it does nothing about the two most important welfare reform issues: **exploding welfare costs** and **the crisis of illegitimacy**. Last year, federal and state governments spent over $320 billion on welfare; by 1998 welfare costs will rise to over $500 billion, costing on average nearly $5,000 for each taxpaying household. And today nearly one in three American children are born out of wedlock; President Clinton himself has warned the illegitimate birth rate will soon rise to fifty percent.

Yet the Clinton "reform" will do nothing to deal with mushrooming welfare costs or the soaring illegitimate birth rate. In fact, on both issues the Clinton plan will make the situation worse.

Why does the reality of the Clinton plan depart so much from the rhetoric surrounding it? No doubt in large part it is because many top officials in the Administration and Congress have long opposed work requirements. It is also because the professional social welfare organizations, which are so influential within the Administration and on Capitol Hill, want more spending on the services they provide rather than real reductions in the welfare caseload.

But if Congress really is to "end welfare as we know it," and thereby improve the lives of those in the system as well as reducing the burden on taxpayers, it must focus clearly on several key goals. Lawmakers must change the incentives in the current welfare system that encourage illegitimacy rather than curbing it. They must channel money now going directly to unwed mothers instead to other ways to improve the lives of affected children. Lawmakers must place a real cap in the growth of welfare spending. And they must introduce genuine work requirements, focusing on those recipients who are most employable—such as able-bodied males—not on single mothers with young children. Legislation to do these things has been introduced (S. 2134, H.R. 4566) by Senator Lauch Faircloth (R-NC) and Representative Jim Talent (R-MO), but is opposed by the White House.

The American people—the poor on welfare as well as the taxpayers who support them—have been promised an end to welfare many times before by congressional leaders and by Presidents. Each time the rhetoric was persuasive, and each time the result was more spending, more people on welfare, and higher rates of illegitimacy. The Clinton plan is merely the latest example. And like the others, it is a fraud.

PROVISIONS OF THE CLINTON BILL

To understand why the Clinton welfare plan will not deliver on its rhetoric, it is important to know a number of key facts about the legislation.

FACT #1: The Clinton bill does not establish time limits on welfare.

Although President Clinton has claimed his welfare reform bill will "end cash assistance after two years," this is untrue. Not one individual will have her cash aid terminated because she has received welfare benefits for over two years—or even for over twenty years. Instead a few individuals who have received AFDC for two years will be placed in a new welfare program misnamed WORK. These individuals will participate in government make-work jobs closely resembling the CETA "jobs" created by Jimmy Carter in the late 1970s. Individuals in the WORK program will continue to be on the welfare rolls and to receive welfare cash aid—but the cash aid will now be dubbed "wages."

Welfare recipients may remain in the WORK program indefinitely and may even be exempted from actual work assignments in the future and be recycled back into the main AFDC caseload. Welfare recipients (including those in the WORK program) may also receive Food Stamps, public housing aid, and medical aid indefinitely; the Clinton Administration opposes placing time limits or work requirements on these programs.

FACT #2: Virtually no welfare recipients will actually be required to work.

When forced to acknowledge that the Clinton plan does not actually terminate welfare after two years of enrollment, defenders of the plan adopt a fallback position: they claim that the plan does at least require those who have received welfare for over two years to work in exchange for further benefits by participating in the WORK program. But this also is untrue. Under Clinton's plan virtually none of the parents who have received AFDC for over two years will be required to work, even in a government make-work job with wages paid by the welfare system.

The bottom line is clear. Among the nearly 5 million families receiving AFDC at any point in time almost half have received AFDC continuously for the last two years, and a far higher percentage have been enrolled for over two years when prior spells on the rolls are counted. Yet, under the Clinton plan, it turns out that only 7 percent of the adult AFDC caseload is required to work under the WORK program and even this requirement will not occur until 1999.

The reason only a tiny number of recipients will be required to work under the Clinton plan is because of the huge number of exemptions and limitations associated with the work obligation. The most glaring exemption is that parents born before 1972 will not be subject to any time limits or work requirements at all.[6] This alone exempts nearly 80 percent of the current AFDC caseload from the work requirement.

FACT #3: Most welfare recipients born after 1972 will not be required to work.

Many journalists and lawmakers, as well as other Americans, might assume that Clinton's rule of requiring work after two years will at least be applied rigorously to recipients born after 1972. But even this is not true. Further exemptions apply to this group as well.[7] Even five years from now, in 1999, only one-third of the AFDC parents who were born after 1972 and who have received AFDC for over two years would be required to work. The "two years and then work" rule is purely cosmetic. It is subject to so many limitations that, if enacted, it would have virtually no effect on the actual operation of the welfare system.

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6 All citations to the Clinton bill refer to *Message from the President of the United States Transmitting A Draft of Proposed Legislation Entitled "Work and Responsibility Act of 1994,"* House Document #103-273 (U.S. Government Printing Office: Washington, D.C., June 21, 1994). This document is hereafter referred to as the "Clinton bill document." All cited page numbers will refer to the large page numbers at the top of each page in this document, which will differ from the page numbers on separate copies of the bill itself. The exemption for parents born before 1972 appears on page 2.

7 In addition to the many layers of exemptions from work, the Clinton bill contains a simple override mechanism which dictates that the number of participants in the WORK program will be determined by the amount of federal funding devoted to WORK divided by a fixed per capita participant amount. Since the WORK program is extraordinarily expensive to operate, this ensures that no more than a small fraction of AFDC recipients will ever be required to participate. See Clinton bill document pages 77 and 271.

FACT #4: Under the Clinton bill, even the small number of welfare recipients required to work must do so for only a few hours per week.

The small number of AFDC recipients who are actually required to work under the Clinton plan will have to perform very little labor. According to the bill, recipients who participate in the CETA-like WORK program will be required to work just 15 hours per week, mainly in public service positions created by local governments.[8] States may require more than 15 hours of labor, but experience from the 1988 Family Support Act, as well as earlier welfare reforms, suggests strongly that most state governments will adhere to the minimum standard. Fifteen hours of work thus will be the norm in all but a few jurisdictions.

FACT #5: WORK participants will be paid well above the minimum wage.

The Clinton Administration has claimed that participants in the WORK program will be paid the minimum wage. This is untrue. The plan actually states that all participants in the WORK program must be paid a wage plus an "earnings supplement," which together must be equal to at least the normal AFDC benefits received by the family.[9] The typical family on AFDC currently receives about $97 per week in benefits.[10] This typical recipient would thus receive a base rate of about $6.46 per hour for 15 hours of work under the WORK program, or almost 50 percent above the current minimum wage.

However, nearly all participants in the WORK program also will receive Food Stamps and Medicaid. The value of this total compensation (cash, food, and medical care) amounts to about $240 per week for the typical AFDC family.[11] With participants "working" for 15 hours per week, total compensation under the WORK program would average $16.00 per hour. (Even if the work standard were doubled to 30 hours per week, total compensation for the average participant would still equal $8.00 per hour.) In addition, WORK recipients will receive free day care. Finally, any state is free to provide any WORK participant with all or part of his or her normal AFDC benefits in addition to the wages paid by the WORK program.[12]

Yet even these above calculations still understate the actual wage rates mandated by the Clinton plan because they do not include an additional hidden wage provision in the bill. This provision stipulates that all WORK participants must be paid an hourly wage at least equal to the wage rates of normal employees within the employing organization performing similar work.[13] Under the plan, most

8 The fifteen hour requirement appears on page 250.

9 Clinton bill document, p. 38.

10 AFDC benefits for a single mother with two children in 1992 averaged $4,785 per year. Assuming a total increase of 5 percent for inflation over the last two years benefits would average about $97 per week in 1994. See Ways and Means Committee, *Green Book: 1993*, p. 1240.

11 Estimated value of AFDC, Food Stamps, and Medicaid for a family of three in 1994 based on data from the Ways and Means Committee, *Green Book: 1993*, pp. 1644 and 1240.

12 Clinton bill document, pp. 250-251.

WORK slots will be provided within municipal governments, many of which have unionized workforces. So in these localities, the bill requires that welfare recipients be paid union-scale wages. For example, if New York City wished to have a welfare recipient perform janitorial services in the public schools, the recipient would have to be paid about $20 per hour.[14]

FACT #5: Many WORK participants will join public sector unions.

Section 103 of the Clinton bill states that participants employed under the WORK program shall be provided with "working conditions and rights at the same level and to the same extent as the other employees of the same employer performing the same type of work" and having a similar length of employment.[15] This means that if the welfare recipient were placed in a unit of government which was unionized, the WORK participant would become part of the bargaining unit and would be represented by the union. If the municipality had a closed shop rule, the welfare recipient would become a union member and government funds would be used to pay the required union dues.

FACT #6: The bill limits useful work.

The Clinton plan makes it difficult for local governments to place WORK participants in useful work by creating strong barriers against jurisdictions wishing to fill normal job openings within the government with WORK participants. When a normal government job becomes vacant, WORK participants must be given the lowest priority in filling that job. WORK participants can fill normal job vacancies only after the government has attempted to fill the vacancy unsuccessfully through normal employment channels for at least 60 days.[16]

This provision will tend to push welfare recipients into pointless, make-work positions reminiscent of CETA program in the 1970s, which provided "jobs" such as attending dance class and performing street theater. In the real world, it is also probable that a large number of the "jobs" provided under the WORK program will consist of para-political activity such as voter registration drives as well as advocacy activities under the auspices of the Legal Services Corporation and other "public interest" legal centers.

FACT #7: The minimal work requirements are improperly targeted.

The work requirements in the Clinton bill are poorly targeted and inefficient. Proper work requirements should be targeted on those welfare recipients who have the least justification for being out of the labor force: single able bodied males, fathers in two-parent families, and single mothers with older children. But

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13 *Ibid.*, p. 233.

14 The beginning salary for a janitor in the New York public schools is $40,000 per year or roughly $20 per hour. Senior janitors receive up to $38 per hour. Charisse Jones, "Pact Breaks Grip of New York School Custodians," *The New York Times*, May 5, 1994, pp. A1 and B8.

15 Clinton bill document, p. 12.

16 Clinton bill document, p. 224.

Clinton's plan focuses on the least employable welfare recipients: young single mothers with pre-school children. Clinton thus reverses the emphasis of current law by phasing out current work requirements on employable males while creating new (but modest) work requirements for single mothers with young children.

Current law properly focuses workfare on the most employable AFDC families. These are the 300,000-plus two-parent families in the Aid to Families with Dependent Children-Unemployed Parent (AFDC-UP) program. Under existing law one of the two parents in an AFDC-UP family will be required to work in community service (workfare) in exchange for the family's welfare benefits. This work requirement will cover up to 75 percent of AFDC-UP families in the mid and late 1990s.

Experience shows that firm work requirements on AFDC-UP families will cause an immediate drop in caseloads and large savings for the taxpayer. In 1983, Utah imposed a 40-hour-per-week work requirement on parents in their AFDC-UP program. The result was an immediate 90 percent reduction in that caseload.[17] Faced with having to perform serious work for their family's welfare benefits, most AFDC-UP fathers went out and obtained real jobs in the private sector. Utah's AFDC-UP population has remained at ten percent of the pre-workfare levels since 1983. Broadening and toughening the current nationwide work requirements on AFDC-UP families could save the taxpayers up to $15 billion in the next five years alone.[18]

But rather than toughening existing AFDC-UP work standards, the Clinton bill takes the unfathomable step of phasing them out by 1998.[19] The meager alternative work requirements in the bill would focus on exactly the wrong population: young single mothers, many with pre-school children. Because of the huge day care costs associated with trying to impose work requirements on this group, the result will be a great increase in welfare spending and barely a dent in the AFDC caseloads.

The inefficient nature of the Clinton work requirements perhaps should not come as a surprise. The Clinton Administration represents the interests of the professional welfare industry, which is naturally threatened by any reform which will significantly reduce welfare caseloads. By contrast, welfare bureaucrats are delighted by "reforms" which require them to provide an ever expanding array of

17 See Robert Rector, "Welfare Reform, Dependency Reduction, and Labor Market Entry," *Journal of Labor Research*, Summer 1993, pp. 284-297.

18 The Faircloth-Talent welfare reform bill (S. 2134 and H.R. 4566) establishes work requirements modeled on the Utah plan on the entire nationwide AFDC-UP caseload starting in 1995.

19 The Clinton Administration has sought to abolish the current AFDC-UP work requirements since coming into office in early 1993. The original draft of the Clinton welfare bill circulated in late June of this year, when the President announced his plan, again sought to abolish the separate work requirements on AFDC-UP families. Stung by immediate criticism showing that this would result in a net reduction in the total number of welfare recipients who would be required to work for the next five years, the Clinton Administration hurriedly revised its bill. In the present draft the existing AFDC-UP work requirements are retained, but only through 1998; they are then eliminated.

services to their welfare clientele (such as lengthy negotiations of career goals and plenty of training and day care). Growing welfare caseloads mean full employment and plenty of career potential to welfare bureaucracies; shrinking caseloads mean the opposite. Therefore, despite pious rhetoric, most welfare bureaucracies quietly but strenuously oppose any workfare measures which will quickly cut caseloads. Instead, they relentlessly promote "investments" which increase costs but are claimed to reap savings at some ever-receding point in the future.

Fact #8: The costs of operating the work program are exorbitant.

Although the Clinton plan will require only a small percentage of welfare recipients to work, and those only for a few hours per week, the per recipient cost of operating the WORK program will be extremely high. The Clinton bill allocates $4,000 per year for each participant in WORK just to cover the administrative costs of the program (roughly $3,000 in federal funds and $1,000 in required state funding).

It should be emphasized that this $4,000 per year cost is not for training or education. It simply represents the extra cost of supervising an individual in a WORK slot. Day care and wage subsidies will add even further, large costs. Although the Clinton Administration has not provided clear figures, it is likely that maintaining a single individual in the WORK program will involve some $8,000 in extra expenses above the level of conventional welfare benefits.

In the typical state, the total taxpayer cost for a family of three participating in the WORK program for 15 hours per week is likely to be around $20,000 per year —a figure covering all wage subsidies, food stamps, medicaid, administrative costs and day care. Many participating families would receive even further benefits through other welfare programs such as public housing, WIC, school lunch, and energy aid. According to the rhetoric of the Clinton Administration, such a family is said to be "off welfare."

FACT #9: The Clinton bill is not deficit neutral.

In addition to the high cost of operating the WORK program, the Clinton bill calls for a wide variety of other increases in welfare spending. It provides new funding for education, training, daycare, and administration of the JOBS[20] program (for individuals who have been on AFDC for less than two years). Other spending items include increases in welfare benefits, expansions in welfare eligibility, and daycare subsidies for single mothers who have found employment and left AFDC.

The Clinton Administration nevertheless claims its bill is deficit neutral. Officials say the new spending will not increase the deficit because it is paid for by spending cuts in other government programs. This claim is false. What the Ad-

20 JOBS is the acronym for the Job Opportunities and Basic Skills program, created by the 1988 Family Support Act. This is not a jobs program, despite the acronym, but instead mainly requires welfare recipients to look for employment through "job search" programs.

ministration does is take advantage of a loophole in federal budget law which requires that the financial impact of proposed legislation be estimated only for five years into the future. It turns out that much of the increased welfare spending in the Clinton plan is scheduled to occur in the sixth year and beyond—conveniently outside the period for which costs must be calculated. Clinton's proposed spending cuts, if enacted by Congress, may be sufficient to pay for the proposed spending increases over the next five years (from 1995 through 1999). But the plan does not even attempt to pay for the extra spending increases mandated to occur after 1999. These future welfare spending increases will be paid for either by higher deficits, higher taxes, or both.

Fact #10: The Clinton plan makes no attempt to control the growth of welfare spending.

The federal government currently runs over 70 different welfare programs providing cash, food, housing, medical care, training, and social services to low-income Americans. Federal and state welfare spending combined amounted to over $320 billion in 1993.[21]

Even without any changes in law, welfare spending will rise to over $500 billion per annum by 1998. In that year, the cost of welfare will equal nearly $5,000 for each tax-paying household. The U.S. then will spend two dollars on welfare for each dollar spent on national defense.

Clinton's response to this spending explosion is to call for even more spending. He attempts to defend his proposed spending increases by claiming that welfare increases are an investment which will yield long-run savings. This is a time-worn ploy. Proponents of nearly every welfare expansion in the last 30 years have justified new spending as an investment which will ultimately save money. Of course it never does. In launching the War on Poverty, for instance, Lyndon Johnson proclaimed that the war would be an "investment [which] will return its cost manyfold to our entire economy." Since Johnson's proclamation, annual welfare spending has increased nine-fold, after adjusting for inflation. As with past "reforms," Clinton's plan can be expected to increase welfare spending and caseloads.

Fact #11: The Clinton bill ignores the Illegitimacy Crisis.

The most serious fault in the Clinton reform plan is that it avoids the central problem of welfare almost completely: America's soaring illegitimate birth rate. In addition to all its other deficiencies, Clinton's proposal focuses almost exclusively on the superficial symptom of welfare dependence and ignores the underlying cause of this dependence—the sky-rocketing number of out-of-wedlock births. Last year, over one million children were born out of wedlock. Nearly one-third of all American children are now born to single women, up from around 8 percent when Lyndon Johnson launched the War on Poverty in 1965. The real

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21 This figure covers means-tested programs for low-income individuals and communities. General spending programs for the middle class, such as Social Security and Medicare, are not included.

goal of welfare reform should not be to put thousands of single mothers in government make-work jobs, while their children are raised in government day care centers. It must instead be to reduce dramatically the number of children born out of wedlock.

Clinton's rhetoric on the question of illegitimacy has been quite good. The President correctly states that illegitimacy is a key cause of crime in the United States. He also points out correctly that welfare plays a major role in promoting out-of-wedlock births. And in his State of the Union message this year, Clinton warned that unless something dramatic is done, half of all American children will soon be born out of wedlock.

However, despite his laudable rhetoric, the President proposes no serious policies to combat the illegitimacy crisis. In fact, his reform plan would go in the opposite direction, establishing pilot programs to provide new cash welfare entitlements exclusively for unmarried mothers.[22] Even worse, by claiming to provide fundamental reform while changing virtually nothing, the Clinton plan, if enacted, will substantially relieve public pressure for change. Thus, it will effectively shut the door on desperately needed real reforms for the next five or ten years.

Fact #12: On teen abstinence, the Clinton Administration uses conservative rhetoric to camouflage liberal policies.

In an attempt to camouflage his Administration's policy vacuum on the crisis of illegitimacy, the President has included some small sex education programs in his bill. In describing this feature, like other provisions, the President uses bold, conservative rhetoric. In advertising the proposed education programs, Administration materials proclaim,

> [W]e need to send a strong signal that it is essential for young people to delay sexual activity, as well as having children, until they are ready to accept the responsibilities and consequences of these actions. It is critical that we help all youth understand the rewards of.... deferring childbearing until they are married.[23]

But once again, conservative rhetoric conceals a contradictory liberal policy. In establishing the proposed education programs, the bill itself never mentions marriage, abstinence, or moral education to delay sexual activity. This should perhaps come as no surprise, since Health and Human Services Secretary Donna Shalala has spent most of the last year seeking to abolish the federal government's only abstinence education program. In its place, the Clinton bill will promote a stock set of tired policy failures: lavish condom distribution, "self-confidence" programs, values clarification, "life-skills training," and "decision-making skills training."[24]

22 Clinton bill document, pp. 496-504.
23 "Work and Responsibility Act of 1994: a Detailed Summary," p. 32.
24 Clinton bill document, pp. 365, 351.

If the Clinton Administration proposed a broad effort to promote moral-based abstinence education, this could be expected to cause a modest reduction in illegitimacy. Such programs have a demonstrated track record.

Example: Students who participated in the Title XX-sponsored program "Sex Respect: The Option of True Sexual Freedom" had considerably lower pregnancy rates one and two years after participation than the comparison group.[25]

Example: San Marcos Junior High School, San Marcos, California, has also used an abstinence-only program. The year before it was implemented 147 girls were reported pregnant. Two years after its initial implementation only 20 girls became pregnant.[26]

However, HHS Secretary Donna Shalala is vehement in her opposition to such programs. Commenting on her elimination of Title XX funds she said: "abstinence-only messages provide no hope of protection at all against the risks of pregnancy and disease."[27]

Thus, despite its conservative rhetoric, Clinton's bill does not proposed to expand abstinence education. Instead, the proposed programs will be closely modeled on affect-based drug education programs. But, according to one of the principal originators of the techniques used in these programs, psychologist W.R. Coulson, such programs, featuring life-skills training, self-esteem building, and decision-making skills, have been shown scientifically to increase drug, alcohol, and tobacco use.[28] Similar counter-productive results can be expected from Clinton's education proposals.

TRUE REFORM

Even the simplest analysis of the White House proposal shows that Clinton's "time limits" and "work requirements" are a sham. Moreover, the President's "reforms" do not seriously address the more important issues of reducing illegitimacy and controlling welfare costs. True and comprehensive welfare reform is needed.

25 Project Respect, *Final Report; Office of Adolescent Pregnancy Programs.* Performance Summary Report, # 000816, Title XX, 1985-1990

26 Dinah Richard, "Has Sex Education Failed Our Teenagers; a Research Report" Focus on the Family, Pamona, California, 1990, pp. 56-60.

27 Cheryl Wetzstein, "Teen Abstinence funding deleted in Clinton Budget," *The Washington Times*, May 23, 1994, p. A-11.

28 W.R. Coulson, *Questianity: Why the War on Drugs Drags*, Research Council on Ethno-Psychology, Box 134, Comptche, California 95427. Dr. Coulson was a close associate of Dr. Carl Rogers and one of the originators of non-directive therapy and values clarification during the late 1960s and early 1970s. Coulson's techniques serve as the basis for most programs featuring decision-making and life skills training in the public schools. See also, William Kilpatrick, *Why Johnny Can't Tell Right from Wrong* (New York: Simon and Schuster, 1993).

Only one piece of legislation before Congress provides real reform. This is The Welfare Reform Act of 1994 (S. 2134) introduced by Senators Lauch Faircloth (R-NC), Charles Grassley (R-IA), and Hank Brown (R-CO) with a companion bill (H.R. 4566) introduced by Representatives Jim Talent (R-MO), Tim Hutchinson (R-AZ), and Charles Canady (R-FL).

This legislation embodies four basic reform principles:

❶ **It reduces illegitimacy** in the future by eliminating those welfare benefits which subsidize and promote out-of-wedlock births.[29]

❷ **It provides an improved quality of life** for those children who are born out of wedlock in the future. It does so by channeling those welfare funds which, under the current system, go directly to unwed mothers, into alternative and superior forms of care, such as adoption services and closely supervised group homes for young unmarried women and their children.

❸ **It controls the size of the welfare state** by putting a cap on the future growth of aggregate federal welfare spending.

❹ **It establishes serious but sensible work requirements** for welfare recipients. It does so by focusing those requirements on the most employable welfare recipients first (such as single able-bodied males and fathers in two parents families), rather than on single mothers with infant children.

The authors of this legislation realize that the welfare system is waging a war of annihilation against the American family. In that war, welfare is winning and the family is losing. Welfare pays low-income Americans to adopt self-defeating courses of action. By encouraging young women to have children out of wedlock, welfare ruins the lives of the women and their children. The disintegration of the family promoted by welfare is, in turn, a major cause of most of America's other social problems including crime, poverty, school failure, and drug and alcohol abuse.[30]

CONCLUSION

Candidate Bill Clinton vigorously promoted his pledge to "end welfare" throughout the presidential election campaign. It is unlikely that voters listening to this thought that "ending welfare" meant what President Clinton now proposes: requiring just 7 percent of the AFDC caseload to work in public sector make-work jobs by the end of this century.

29 One year after enactment, the bill would eliminate AFDC, Food Stamps, and Housing aid to women under age 21 who have children out of wedlock. Since the bill is intended to affect the future illegitimate birth rate, the cut-off would be prospective; it would not affect women who had children out-of wedlock before the cut-off date. All savings from the elimination of direct welfare payments to unmarried women would be directed to alternative methods of caring for illegitimate children, including adoption and closely supervised group homes for unmarried mothers and their children.

30 See Patrick F. Fagan, "Rising Illegitimacy: America's Social Catastrophe," Heritage Foundation *FYI* No. 19, June 29, 1994.

Administration officials argue that reform must be incremental and that changes take time. However, the true rationale of the Clinton plan can be better understood by examining the history and politics of the issue of work and welfare. The liberals who have dominated the U.S. Congress have adamantly opposed work requirements for welfare recipients for nearly a quarter century.[31] Many of the liberal professionals who staff key posts in the Clinton Administration share this view.[32] But since over 85 percent of the public now favor making welfare recipients work, most liberals no longer publicly oppose work requirements. Instead, they have adopted Fabian tactics, seeking quietly to minimize and delay work requirements as long as possible, while publicly claiming to support them. While public disaffection for welfare is assuaged through sham work requirements, liberals quietly move to expand welfare programs. This strategy of delay and obfuscation packaged as "bold reform" began with the Family Support Act of 1988 and will continue for the foreseeable future.

Unlike Bill Clinton, Senator Faircloth and Congressman Talent realize that the War on Poverty has failed. The Faircloth-Talent bill delivers what Clinton promised: if not an end to welfare, at least the beginning of fundamental change.

Robert Rector
Senior Policy Analyst

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31 Senator Russell Long first proposed the idea of workfare (requiring some AFDC recipients to work for benefits) in the early 1970s, but his ideas were blocked by liberals in Congress. During the late 1970s, the Carter Administration actually declared workfare illegal and expelled the state of Utah from the AFDC program for a number of years for attempting to make some recipients work for benefits. In 1981, President Reagan finally succeeded in making workfare legal, providing states with the option to operate very limited workfare programs. However, Reagan's repeated efforts to require even a small fraction of the AFDC caseload to actually participate in job search or workfare were rebuffed by Congress on a yearly basis during the mid-1980s. During the 1988 reforms, efforts to require even a small percentage of AFDC recipients to participate in job search or to work for benefits again were opposed by liberals led by Senator Moynihan. Conservatives led by then-Representative Hank Brown (R-CO) and Senator Bill Armstrong (R-CO) succeeded in establishing, over liberal opposition, actual work requirements for some AFDC-UP recipients to take effect in 1994. Thus due to persistent liberal opposition, nearly a quarter century passed between Russell Long's initial proposals for workfare and the time when the federal government actually required the first AFDC recipient to work for benefits. See Lawrence M. Mead, *Beyond Entitlement: The Social Obligations of Citizenship* (New York: The Free Press, 1986).

32 For example, HHS Secretary Shalala is a former member of the board of the Children's Defense Fund, an organization which historically has taken the lead in opposing even token work requirements for welfare recipients.

It is the old paradigm, shall I say, the heavy hand of the Federal Government, notwithstanding some talk about State flexibility. Welfare spending is far from controlled. It is going to be a very expensive proposition.

CBO recently increased the estimate of what this is going to cost. This is the canard we are always told in Washington. We are spending $320 billion at the moment, we have to spend more in order to have longer term effects. That is straight out of the 1987–88 welfare debate. It does nothing to control it, but increases welfare spending. It is a costly proposition.

Even the modest work program doesn't go into effect until the outyears because it is so expensive. Only 7 percent of the AFDC caseload has any obligation to so-called work by the year 1999. That is because it is so costly, $4,000 per person in administrative costs alone. When they may work, they can be in a public-sector make-work job, the obligation being 15 hours a week endlessly, a make-work job for 15 hours a week.

So it is not serious with respect to its professing to put people to work and notwithstanding the President having told us that he recognizes the problem of illegitimacy, the destructive role welfare has played, illegitimacy is linked with crime, all of this the President has recognized and to good effect has used the bully pulpit, his bill totally ignores the problem of illegitimacy.

Mr. ENGLISH. Thank you very much.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Payne.

Mr. PAYNE. Thank you, Mr. Chairman. I would like to return to the issue of national savings which was a subject that was discussed earlier. I think as we pursue the policies that we are looking at on this committee, the Contract With America and other economic policies, certainly we need to ensure that we are being fiscally responsible. As I heard the two economists say, Dr. Bosworth and Dr. Boskin, that in terms of good public economic policy increasing the savings rate is a policy goal that should be at the very top of the list.

Is that correct?

Mr. BOSKIN. The national savings rates.

Mr. PAYNE. It was said by someone on this committee yesterday in questioning that, of the G–7 nations, we are dead last in terms of our national savings rates, that there is something going on in the other six industrialized countries, they are doing different things in terms of public economic policy that may encourage savings, things that we are perhaps not doing.

Are there things that we can learn from what is happening in other industrialized nations that could be effective to us?

Mr. BOSKIN. I think it is a common supposition that one of the differences is that their tax codes in some of those countries, the Western European countries, not Japan, the overall tax burden is higher than the combined Federal, State, and local burden here, but when you work through even their income taxes, they tend to tax consumption rather than income, and they tend to have far more vehicles for tax-exempt saving in Japan than in the United States.

When you get behind the simple statutory structure of their tax systems and look at what the effective rates are on capital, economists believe that that is one of the reasons. There are undoubtedly others. We had, until recently, when they started running large budget deficits, they used to have much closer to budget balance than we had for the seventies and eighties. In recent years, because of their cyclical downturns, but also because of their exploding entitlement spending, benefit payments to people that people get if they don't work is one reason they have a high unemployment rate—those two things have caused them to have much bigger public dissaving than they used to.

So it is a correct historical statement. I think if you looked at 1995, it may be a bit of an exaggeration if you started to look at some of the exploding public borrowing of those places. We have low private saving and we have been dissaving publicly. More of the difference and more of the decline in our national savings rate from the sixties and seventies is due to a decline in net private saving than to an increase in public dissaving.

Mr. PAYNE. Is there anything, Dr. Bosworth, that you would add to that?

Mr. BOSWORTH. Only that I am surprised by the last statement. What all these countries have in common is that the driving force behind it is the decline in national savings which has occurred in all the industrial countries which has been explosions in the public-sector budget deficit. We all have the same difficulty.

The differences in private savings rates are true. We are dead last among the major OECD countries in the rate of private saving in the United States. Americans have always been a low savings rate country. Perhaps it is because of cultural attitudes and American optimism about the future. I don't know.

It turns out we didn't get rich by saving a lot. We got rich by avoiding fighting any wars on our own shores. Other countries save more than we do and then every 50 years blow it up and have to start over. I think the evidence by economists is very discouraging about the argument that the differences are due to the tax system.

I recommend a recent study by Dale Jorgenson at Harvard which does 13 different industrial countries' tax systems and their taxation of capital income and can find no systematic relationship between rates of private saving and rates of capital income taxation.

I think a lot of it is cultural. I think the Japanese make a tremendous emphasis on saving. They look just like the American emphasis on consumption. We measure people by how much you consume. They tend to measure people by how much you save. And I think that a lot of these attitudinal differences lie at the core of differences. Also access to credit. In the United States, it is so easy to borrow, easier here than in any other industrial country.

Mr. BOSKIN. I second the last point, but add that Japan became a high savings rate country after World War II. Japanese history isn't of high savings rates, and I don't think Japanese culture, the typical conventional wisdom stereotype is Japan has changed very slowly culturally. If so, then it can't all be cultural, because they had a low savings rate before.

There are many things to do with demography rates and economic growth, and I believe the evidence is stronger that taxes play a role.

Mr. BOSWORTH. What I meant by cultural is after World War II and the shortage of saving, the Japanese Government put enormous public emphasis on the benefits of saving, every household should have a saving account, the postal saving system.

Mr. BOSKIN. And you could save $30,000 a year tax free.

Mr. BOSWORTH. That is true.

Chairman ARCHER. The gentleman's time has expired.

Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman.

Mr. Bosworth, coming from the private sector, and over the last several years, I have seen the experts testify during recessions that we can't cut government programs and spending at that point because of the deleterious effect that it would have on the economy, that it would send us into a deeper recession. Would you agree with that?

Mr. BOSWORTH. No, I don't.

Mr. ENSIGN. You wouldn't agree that cutting government spending can have somewhat of a job-cutting effect in the short term?

Mr. BOSWORTH. I think that that was a major concern 20 years ago in the United States when we were largely a closed island economy. Once you moved into a global international market, many of the short-run benefits of fiscal stabilization went away.

I now think we are far better off to focus on the long run for all fiscal policy. The issue of short-run stabilization should be handled by the Federal Reserve.

Mr. ENSIGN. Right. But in the short run, most people would say that it has a tendency to cut jobs and slow the economy even if only in the short run.

Mr. BOSWORTH. Yes, a little bit.

Mr. ENSIGN. OK. The point I am trying to make is when we talk about times like the present we say this is a good time to cut spending, but a bad time to cut taxes because we will increase jobs, we will get the economy going too much.

In the Contract With America we are talking about cutting spending, because we have committed to cutting spending first. At the same time in cutting taxes, we are worried about the Federal Reserve increasing interest rates.

Are they not going to have an offsetting effect as far as overstimulating this overheated economy and therefore take away the argument that we are going to have an increase in interest rates?

Mr. BOSWORTH. If they really did occur at the same time so that there was no net effect on the budget deficit, I don't think there would be any effect on interest. The truth is I don't believe you. I have heard this from Congress over and over again.

You keep telling me you are going to cut expenditures and, boy, we will have these tax cuts and just wait, I will come forward. I want to see the specific expenditure reductions you have in mind. You have an amazingly detailed facts program. I have not heard the same degree of detail on the expenditure side.

Mr. ENSIGN. So if we came forward with those spending cuts and we were paying for the tax cuts, as we said we will, then you think that this wouldn't have the effect that some economists have talked about, overheating the economy and raising interest rates. That argument then would go away for you?

Mr. BOSWORTH. Yes. I would only say that you have passed up an amazingly good opportunity to reduce the deficit. By holding it constant you will have no net effect, because I think that is what financial markets sort of believed up until now: The deficit was always going to be there. So if you don't change, it won't hurt anything, but you are missing an opportunity, a wonderful opportunity to reduce the budget deficit, to take those expenditure cuts which you should make and pass them forward into reductions in deficit and government borrowing, not tax reductions.

Mr. ENSIGN. Let me follow that up further with Dr. Boskin or Ms. O'Beirne. When you are looking at cutting the spending program that we are talking about, and I don't know how you feel about certain tax cuts, such as capital gains, which may stimulate the economy to the point that tax revenues will then be increased, would that not then be reducing the deficit if you are not just looking at a static model, but rather at a dynamic model?

Mr. BOSKIN. I think as a general proposition, cutting spending and taxes by the same amount when you score properly would—I think Barry is correct. I do believe some of these taxes, tax reductions that are talked about will have the advantage of increasing the potential supply in the economy and enable us to grow more rapidly without inflation, although I would agree, before Barry jumps in, the estimate of the size of those—the Chairman's indication of looking at a range and being conservative about it is up for dispute, certainly.

Mr. ENSIGN. Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

I don't blame you, Dr. Bosworth, for your cynicism. It has been that way for the last 40 years, but I think we are in a new world, and I know you will judge us by what we do and not by what we say.

But my question is for Mr. Novak, and I don't know if you have read Marvin Olasky's book, but in that book he talks about the importance of a community in giving people a hand up and not a handout and I agree. I guess my question is can the Federal Government create a welfare system that encourages the Nation to be more dependent upon one's self rather than creating permanent dependency on government?

And in addition to that, Ms. O'Beirne's colleague at the Heritage Foundation, Robert Rector, has thrown out a lot of different ideas on welfare reform. One, sending back block grants to the State. Another idea, sending a tax refund back to the people in the amount of money we save in welfare and letting the States handle it and figure out where they are going to come up with the money.

I guess I would like to hear your thoughts on that as well as Ms. O'Beirne's.

Mr. NOVAK. Thank you.

I led a study group consisting of both Democrats and Republicans, Conservatives and Liberals, in 1987 on what was then called the New Consensus on Family and Welfare.

And the first step this group took was to look at what had worked well in welfare programs in the past and what had not worked well, what had and had not gone right since the sixties. On the whole, the condition of the elderly (who were the group most disproportionately poor in the sixties) improved tremendously, perhaps even too generously. Whereas the elderly had been the single largest group of the poor, they are now the smallest.

Where the welfare programs went wrong was with young, healthy people. Here for the first time in our history we created a large group of people, about 9 million adults or so, who are healthy and able bodied and have learned to be dependent on the State. This had never happened before in our history. I think this is what is frustrating people.

Some of the reasons why this happened, in addition to what government did, were what the media and the general circulation of attitudes did, what happened in the larger culture, which Congress can't do very much about, except put certain ideas on the agenda and keep talking about them. We talked just a moment ago about encouraging savings, for example.

Given our beliefs, Americans have to care about the poor people in their midst. People who are not poor outnumber the poor by 9 or 10 to 1. Seventy-one percent of those people who regularly take part in their churches are now participating in volunteerism, if I can cite a number of Mr. Olasky's by memory. And they are giving on average 3 or 4 hours a week to this work. Much more of that can be done. In all of these neighborhoods there are churches.

One more point we discovered. Sixty percent of the AFDC cases are in 10 States. That means 40 States have the other 40 percent. The situation from State to State and from county to county varies enormously.

Why are all States approaching welfare by the same set of Federal regulations? It doesn't make any sense. If you devolve authority back to the States and to counties and local governments, and then encourage the doctors and the lawyers and the realtors in each locality to work on the problem of the homeless for instance, I think the American people would respond. Ours is supposed to be an experiment in self-government. The people are responding and they need more encouragement in that direction.

I want to say one other thing. If you do three things in the United States, it is very hard to remain poor. If you get married and stay married, even if not for the first time, you have a 93-percent chance of not being poor. If you finish high school, you have about a 90-percent chance. If you work full-time year round, even at minimum wage jobs, you have about the same.

If you cross those three lines, then there are still some poor people, but they are few in number and those don't stay in poverty for long. If we could make clear what works, I think the American people would pick it up.

Mr. CHRISTENSEN. Mr. Novak, I think that is a very important figure that we haven't heard yet today or even this week on the panels, 93 percent, you say, of those people that stay married or are married at one point in time in their life——

Mr. NOVAK. Are not poor.

Mr. CHRISTENSEN [continuing]. Are not poor. And yet our government has been perpetuating the marriage penalty and continues to perpetuate the marriage penalty in some of the administration's policies, and that is a very startling fact.

Thank you for your testimony.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. McCrery will inquire.

Mr. MCCRERY. Thank you, Mr. Chairman.

Welcome, panel. It has been a most interesting discussion.

Through my years on the Budget Committee and now Ways and Means, I have come to love economists. In fact, they are a lot like Congressmen. Each one has a very, very strong opinion, and each one is extremely convinced that he is correct.

But for us policymakers, listening to economists, it makes our job doubly difficult because both Dr. Boskin and Dr. Bosworth are extremely articulate. I have read both of your prepared testimonies and they are excellent. And they are diametrically opposed on a couple of key points, capital gains being the most obvious.

And I would love for you two guys just to go at it for a while and let us listen, but our structure doesn't allow that and neither one of you wants to do that, so I will have to proceed with my questions.

Dr. Boskin, first of all, in your testimony you say: "Finally, and most importantly, a reduction in the capital gains tax would increase the supply of entrepreneurs."

Would you expound upon that a little bit?

Mr. BOSKIN. I think there are many studies of capital gains tax rate reduction, and there are sort of standard kinds of statistical procedures that economists use to analyze it. You see what it does to the conventional estimate of the cost of capital and you have a model about what that does to investment and so on.

Among the things that I think has made our economy strong and is a tremendous advantage of America's economy relative to Japan and Western Europe and other industrialized countries but is enormously difficult to quantify, is that we are a much more entrepreneurial, flexible, dynamic economy. We have many more businesses starting, and I might add, many more businesses failing as a result of that, but then people get up and try again.

I come from an area at Stanford which is on the tip of Silicon Valley, between Silicon Valley and San Francisco, and while some of the funds that go into traditional venture capital, when you get to that stage people usually get money from a tax source first, but then by the time they get to a form of venture capital fund, some of that is coming from tax-free pension funds or tax-deferred pension funds and so on, but I think there is a general feeling that if you have a climate that rewards entrepreneurial efforts substantially that you will have more people willing to leave their decent-paying job at a stodgy, old firm—I won't name any particular ones—say a stodgy, old computer firm and try to start a new one, take their idea and run with it, see if they can build a business, build an industry and create more.

I happen to believe that is more important, but I would be the first to admit that is the thing that economists have the most difficulty quantifying. If you look at startups and look at where they got their first money, over 80 percent came from taxable sources in the first round and then they go to venture capital and some of that comes from tax-exempt sources. So it is that spirit that I am trying to incorporate, but I think it is just not easy to quantify.

Mr. MCCRERY. I thank you for that explanation.

I would like to go into that further, but let me get to Dr. Bosworth. Actually, I am going to quote Dr. Bosworth and get back to Dr. Boskin.

Dr. Bosworth, in his written testimony, and I think also he talked about it a little, he said that rather than reduce the capital gains rate, we ought to index all capital income. And he said if you do just one and not the other, if you just reduce—if you just index capital gains but not other capital income, or if you reduce the capital gains rate, then you skew the system and you encourage certain types of activities that is not necessarily advantageous.

Do you, Dr. Boskin, have a retort to that?

Mr. BOSKIN. I am partially sympathetic to the notion, as my earlier testimony indicated. I do believe, however, that we have a serious problem of trillions of dollars of locked-in capital. People have to pay a huge toll to get out of an existing appreciated asset, whether it is nominal or real gains that they have had. Twenty-eight percent of the top rate at the Federal level, plus State taxes, let's say, it is 35 or 40 percent.

You pay that today to get out of one asset to try to go into something that is likely to be more productive and help the economy, but that return is uncertain so you need more than a 35- or 40-percent expected premium to compensate. You are giving up certain extra taxes today for some possibility of higher return tomorrow. I happen to believe that both a rate reduction and indexing would be desirable. I am concerned about the tax arbitrage that Barry mentioned. It is an issue that you should be confronting in design.

I would add, however, that we have, for example, in housing, tax-free rollover. My own opinion, in an idealized world where there weren't all these other constraints, the appropriate tax treatment of capital gains would be tax-deferred reinvestment. Zero rate when you reinvest it and then taxation when it was taken out and consumed, when people stop and took it out and didn't reinvest it, indexed for inflation. That is sort of the goalpost or guideline I would aim for. I do believe—contrary to Barry, I believe the partial reforms would be a big improvement.

Mr. MCCRERY. Thank you, Mr. Chairman.

I want to get back later, if we have a chance, but Ms. O'Beirne I hope will be thinking about a welfare system equaling EITC, with some corrections from Mr. Collins, plus disability, plus the unemployment compensation. And I would like to ask you about that later.

Ms. O'BEIRNE. Good, terrific.

Chairman ARCHER. Let me quickly ask Dr. Boskin and Dr. Bosworth, is there any known study done on this country estimating what percent of capital transactions are reinvested in other capital assets and not converted to consumption?

Mr. BOSWORTH. There is no standard number floating around in the literature that I am aware of, but I think the answer is very high.

Chairman ARCHER. It would be well up into the nineties.

Mr. BOSWORTH. Ninety-five plus, easy.

Chairman ARCHER. Thank you.

Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman.

Ms. O'Beirne, I—first of all, I want to thank all the witnesses for their testimony, but I had just a couple of points I wanted to make.

I think in response to another question and the figures you came to on the cost of welfare programs, that included all means tested programs that you testified to, our research has indicated there are 340 means tested programs, all with their own rules, regulations, and reporting requirements and the bureaucrats, to make sure that the States comply with those reporting requirements, so clearly there is a great deal of room for reform there.

In answer to a question about paternity establishment in the information necessary, I think what I understood you to be getting at was simply to make a very small commercial loan, more information than a name is necessary, like address, phone number, that kind of threshold. And I think what you are getting at is that the parent or the mother would have to not just give a name but cooperate fully and try to give whatever other additional information, any relatives of the father, to try to get this paternity establishment rate up.

Is that what I understand?

Ms. O'BEIRNE. Exactly. Exactly so, Mr. Camp, because to do otherwise would be merely be the status quo which has had a very frustratingly low paternity establishment connected with it.

Mr. CAMP. Some of these high benefit States or high benefit areas, I know it has been a criticism that people would migrate from area to area. And my question to you, is that necessarily all bad and wouldn't that then force States to try to hold down their welfare costs so they wouldn't become the welfare magnet for the Nation? I would like to hear your thoughts on that.

Ms. O'BEIRNE. Good. Certainly.

I would be the first to say that very intelligent, rational people get caught in the system in responding like rational people. And the example of welfare migration that I know Wisconsin has faced is an example of that. I don't think that is a bad thing at all.

The beauty, I think, is the point that Mr. English was getting at. There is so much we simply don't know. We know what has been a colossal failure. We need to know a lot more about what might work. And given the commitment on the part of Governors to do some experimenting for us, maybe on a countywide basis, not even statewide, and as a Conservative, what is so appealing about the different 50 sovereign States is the system works that way.

If I am living in a State whose tax policies, regulation policies I find frustrating and an impediment to living, I can go elsewhere. We don't have that luxury when national policies are adopted out of Washington and we are all made to live under the same one.

And I don't disagree with you at all and would welcome the opportunity to have maybe very, very different welfare systems among the States.

Mr. CAMP. You mentioned in your written testimony that you would like to see that single mothers with "older children be required to work before mothers with preschool children."

Is there an age—this has been the subject of a great deal of debate, and I wonder if you had in mind a particular age limit or threshold?

Ms. O'BEIRNE. I would for the reasons that are perfectly apparent in the administration's proposal which is how extremely costly the younger mothers with younger children are to focus on. Day care costs alone come to $5,000 or $6,000 a year. Given that, these are the mothers who are least job ready, too, as you know, given the need to prioritize, clearly money is better spent on an older, more mature population with older children, so I would concentrate there, after I concentrated on single males in order to make sure that they are working in exchange for welfare.

I think preschool is the good cutoff point, Mr. Camp, because then you get around the child care question. If mothers with only school-age children were first prioritized, I think the States would find it a much more efficient use of those moneys because they do not, with the child in school all day, have those child care expenses, and if need be, the obligation could fit the school day, a 30-hour-a-week obligation in order to coincide with the school schedule.

Mr. CAMP. You would also require that at least half of all AFDC parents work in exchange for welfare benefits. How did you reach that point or could you enlighten us on that, please?

Ms. O'BEIRNE. I think that is the goal that Governors should be asked to try to get to. I think within that maximum flexibility, exactly how, during which period of time, education and training first, job search, that is totally up to the Governors. But I think as long as it is Federal dollars, those sorts of goals ought to be laid out.

Because we are dealing, Mr. Camp, with an able-bodied population capable of working. And I am delighted that Dr. Novak cited what we all know to be true. It is not a thorny proposition. You graduate from high school, you work full time, year round and don't have children until you are married, and this system all but guarantees you will not be in poverty. So imagine the monstrosity that Washington has created, that being the simple truth, in order to have created so many millions of dependent families.

Mr. CAMP. Thank you very much.

Chairman ARCHER. Does Mr. Kleczka wish to inquire?

Mr. KLECZKA. Mr. Chairman, I do, for just a short period of time. I would like to direct my question to Dr. Boskin.

We did have on panel number one a CPA. We did discuss for a short time this thing called neutral cost recovery. And I note in your testimony that you indicate that good cost recovery policy must consider not only interest deductibility but also depreciation writeoffs.

I don't see that in the proposal before the committee on neutral cost recovery. I see the depreciation schedule, index for inflation, plus an added 3.5-percent factor to offset any interest loss because the corporation is giving up the savings or the—the savings.

Are you concerned that we could be establishing another tax shelter by going to this thing called neutral cost recovery? On a piece of equipment with a life of 10 years, using this calculation, I find that the corporation will write off in excess of the original investment. In fact, if you would include the interest expense, that could almost approach another 100 percent of the actual cost.

Mr. BOSKIN. Well, let me just repeat the combination of interest deductions plus depreciation should be equivalent in present value terms of expensing. That is neutral. The specific proposal I think has to be looked at in that context.

I also think that we too often think about depreciation in the traditional wear-and-tear notion. We are not mostly in a wear-and-tear economy anymore. Depreciation of a very large fraction of assets is primarily, as I mentioned in my testimony, due to technological obsolescence, and I think our Tax Code does not take sufficient account of that.

We have whole industries whose product cycles are more rapid than 1 year. We certainly have whole industries whose product cycles and the rate of depreciation—economic depreciation decline in economic value, because one generation of machines or products, whatever, software, computer centers are replaced by the next, is more rapid than the most rapid depreciation.

So I think that depreciation is something that is proper to look into. I think that as a general proposition, depreciation is too slow, but as we have discussed in these other situations, you have got to be careful that a combination of interest, plus depreciation, or capital gains, or whatever, doesn't wind up creating a tax shelter—abusive tax shelter possibilities. The laws have helped reduce that, although I don't——

Mr. KLECZKA. As drafted, do you think the neutral cost recovery system, the proposal before the committee, would have the effect of doing that?

Mr. BOSKIN. I think at times, it would. At other times, it wouldn't. I think you can't make a generalization.

Mr. KLECZKA. Thank you very much.

Chairman ARCHER. Mrs. Johnson will inquire.

Mrs. JOHNSON OF CONNECTICUT. Thank you.

Dr. Bosworth says in his testimony, Dr. Boskin: "There is no shortage of incentives for investment. Business equipment spending adjusted for inflation has increased by 40 percent in the last 2 years."

First, do you agree with that statement, and second, in light of that statement, do you think that reducing the deficit is a more important priority than stimulating investment?

Mr. BOSKIN. Of course, if the deficit is reduced in a manner that does not decrease private saving as, unfortunately, the 1993 tax increases did, it would make more funds available for private investment so they are not—it is not an either/or proposition in that sense.

But it is my own belief that one shouldn't take the shortrun cyclical and technological boomlet in investment, a spectrum-led recovery when people are buying computer equipment and pagers and so on as a permanent feature. If you are writing tax laws, and I agree with Barry that in general, we shouldn't primarily be using the Tax Code for quarter-to-quarter or year-to-year cyclical reasons, but to have a stable basis to have the strongest base and foundation for economic growth for the private sector as possible.

I do believe that there are still problems in the business incentives: Capital gains, depreciation and elsewhere. But you have got to be careful how the thing is drafted or you can get back into the shelter business.

So I think deficit reduction is important, but I think the tax structure is important as well, and I don't think you can say that the amount of the deficit or the amount of the deficit reduction is a sufficient measure of how much you are going to help private—national saving, and eventually in the long run, investment, because I think the—how we raise the revenue affects whether there will be more businesses started, more investment done and more consumption and so on. So I think the structure of the tax system is important as is the level of the deficit, so I think you have to move on both fronts and be careful on both fronts.

Mrs. JOHNSON OF CONNECTICUT. Thank you.

Dr. Bosworth, your comments about our proposed changes in support of the elderly were interesting to me, partly because I do agree with you, that half of our program outlays are already going to the elderly community. But you may not be aware that in the last two Republican budgets, we proposed means testing Medicare premiums.

Do you think it makes better economic sense to means—and fairness sense, is it better policy to eliminate the disincentives to work for retirees, particularly given the weakness of our system in helping people to prepare for retirement, and also restore fairness to the taxation of Social Security benefits, that is, eliminating the double taxation of the portion that was already tax dollars and instead to means test Medicare premiums to cover some of the costs that, frankly, no one paid into that system?

Wouldn't that end up to be a fairer and healthier tax structure, governing both senior activities and senior income tax responsibilities?

Mr. BOSWORTH. Well, two things: One is the proportion of the benefit that the worker had contributed himself and previously paid tax on was not taxed under the proposal. That is where the 85 percent comes from that was going to be included. Only about 15 percent of the Social Security benefits today represents the contribution of the workers. And so it really didn't make a big difference on it. When you get——

Mrs. JOHNSON OF CONNECTICUT. Excuse me. To that point, from the workers' point of view, it is 50 percent.

Mr. BOSWORTH. No, the worker did not—it will in time. You are going to have—your benefit is composed of your contribution, which was taxed, your employer's contribution, which was not, and then the accumulation of an interest, so to speak. In the case of Social Security, the interest rate is actually the rate of growth of productivity plus population. That is not taxed either. So when you look at the outcome of a person's dollar benefits, how much of those dollars adjusted for inflation ever got taxed; 15 percent.

Mrs. JOHNSON OF CONNECTICUT. I don't think that you can necessarily say that the tax liability for that section should go entirely to the individual.

Mr. BOSWORTH. Well, let's put it another way. I have absolutely no objection to treating the Social Security system exactly the way you treat private pension. In fact, I would most prefer that reform; that what you do for Social Security benefit recipients under the taxation of their income is do precisely what is done for private pension, because that is the right way to do it.

With respect to your question about means testing elderly programs——

Mrs. JOHNSON OF CONNECTICUT. Medicare premiums in specific, because those heavily taxed, subsidized——

Mr. BOSWORTH. I understand. I understand. I have one concern with means testing against retirement income. And that is if I know that the better off I am when I retire, the more you are going to reduce my benefit, why the hell should I save for my retirement. You are going to pay. Or what I will do is just before I get to this age, why don't I shove a little of this income off to my children or some others to avoid taxation. I think this country already has too few incentives for people to save for their own retirement and I don't like these proposals that tend to weaken those measures.

Mrs. JOHNSON OF CONNECTICUT. I certainly agree with that. But the small Medicare tax we pay is not an incentive to save, it is an incentive to cover your health care costs. And in the end, 75 cents of every dollar of part B premiums is paid by the taxpayer.

And as to a disincentive because of means testing premiums, there is no more disincentive than an income tax which says the more retirement income you have, the higher tax you pay. I do think it is important to put on the record that we are in a sense redesigning the burden to support work to restore a certain equity to the treatment of Social Security benefits from the payor's point of view, but we are not blind to the responsibility that one must take to one's own costs, particularly in the health care area.

I do want to say in conclusion, because my time has expired, that it ought to be clear on the record that there is no welfare reform proposal that doesn't provide the same money to the States that they are currently getting, so they will have lots of money to provide developmental day care services for 17-year-old mothers who need their faith in themselves restored, who need to manage money better and who need parenting education. So there are resources to do a far greater job than we are doing now because we don't have any money right now to do any of that stuff for teen parents.

So I think the optimism has to come from withdrawing the mandate to provide income benefits for kids and we are losing sight of that in our discussion here in the committee, that there are resources, there will be new programs, and they provide an enormous opportunity in our society for those young kids, teen mothers, not just for government.

Chairman ARCHER. Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman. I will be very, very brief. I don't have any questions. I just want to follow up on what Mrs. Johnson was saying. The gentleman from Washington, Mr. McDermott, a few minutes ago, was talking about how are we going to take kids away from their parents, and that we are going to build orphanages.

We don't do those things. The Federal Government does not do that. I do not know of one single orphanage that the Federal Government has ever built, nor will it ever build one. I do not know of one instance in which the Federal Government has taken a child away from a parent, nor do I think it has the power to do so even if it should want to.

And we certainly on this side of the aisle do not advocate anything such as that. Nancy, I think, brought it out very, very well when she said that we are going to be able to provide services for these young mothers that have never been provided before. The bill in the Contract With America simply takes away cash benefits from these young mothers; 13-, 14-year-old kids should not be receiving cash in lump sums to go out and spend as they see fit. In some instances, it is a sizable part of the inducement for them to end their—really end their economic life and go and commit themselves to a life of poverty just for those few dollars that they are going to get for having that illegitimate kid at a very early age.

This is an area, though, in which I think that we can certainly work together. There is going to be a great deal of latitude given to the States as to how they can handle that money and how they can get these programs going and get in there and service the kids.

A lot of attention has been brought to the almost obscure provision in there that would allow the States to use some of that money for orphanages. That is such a minute part of the bill when you think of how we are trying to build people. I think Ms. Kellogg was very eloquent in her testimony this morning as to what is happening to those kids, how their self-esteem and self-incentive, their empowerment, their drive, anything they had within their own souls to make them succeed is being blotted out by the cruelness of the present system.

Ms. O'Beirne, I would like to compliment you on your testimony in that regard. I think that you have made a lot of sense and a real contribution to the committee.

I would like to just briefly touch on the question of depreciation because that has been a part of the other discussion. I think we need to go back and not return to the old days of tax shelters where people were investing for tax deductions alone, but the depreciation schedules have to be a lot more realistic than they are today.

When you go in and make improvements for a leasehold and then find that you have got to spread that out over the life of the building, even though the lease may be only 5 or 10 years and a specialty type of renovation is made for a particular tenant, businesswise that just doesn't make any sense. And I think we need to go over the code as far as the depreciation schedules are concerned, take into account obsolescence, the rate of technology that is going forward, and the useful life of the improvement that is being made. And I think that this committee would do very well to go about the business of doing that.

If any of the witnesses have anything to add with regard to that, I would welcome their comments.

Mr. BOSKIN. I would agree with your general sentiment. I would just briefly repeat what I said before about being careful about shelters, and I would also add that if you as a committee get around to fundamental overhaul of the tax system as opposed to specific items in the Contract or other things to do, one of the things that you ought to be looking at is whether it is so complicated to have depreciation schedules for all the types of assets and they are going to change over time so rapidly and the Treasury is never going to be able to keep up with it, they are always going to be off, that you might be able to move to a simpler system that did away with all that sort of thing. That is in the future.

Mr. SHAW. Perhaps with some of this type of technology, maybe even with mobile phones or something like that, let people just write them off like you would a small tool and not bother to capitalize them and have to set up these depreciation schedules. Maybe that would be something that we should be looking at it. And even with the area of computers, don't worry about it, just go ahead and get rid of them and write them off and be done with it and try to simplify the way we do business today rather than just overly complicate it.

The revenue stream for the Federal Government over a 5-year period is not going to be really affected by it. I think probably part of the problem is that we do everything within a 5-year window rather than expand that window and try and make more sense out of it and be more user friendly to businesses.

Thank you, Mr. Chairman.

Chairman ARCHER. I am sure every member of the committee joins me in complimenting each of you for the contribution that you have made today to the deliberations of this committee. I think this panel has been outstanding. We want to continue to draw on your expertise as we move along.

Thank you very much.

Mr. MCCRERY. Mr. Chairman, could we have another round, if they are willing to stay for just 1 minute?

Chairman ARCHER. Well, we have significant time constraints with another panel coming up. I wonder whether we will be able to complete the business of the committee today in an expeditious manner. If there are no other members who want to pursue additional questioning, I am sure we can accommodate one member.

Two. All right.

Is that it?

We will take one from each side for second questions.

Mr. MCCRERY. I think mine will be short. I don't know about Dr. McDermott's.

Chairman ARCHER. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

Ms. O'Beirne, I gave you a formula for welfare before I ended my earlier round, which is my ideal formula for welfare in this country: Welfare equals EITC, plus disability, plus UC. That would be it. Simple. If you don't work, if you are able bodied and you don't work, you don't get welfare. And that would be, I think, the ideal system.

However, since that would make—cause you to talk for longer than we want, perhaps maybe we can get together some other time and talk about that. But I am concerned about your statement that under your ideal welfare system, if people collect welfare, perhaps they should do community service jobs. In effect, they would have a public job.

Do you—and maybe there is—and I hope there is more to that concept than you have given us today. Would you put any limit on that community service in terms of years performed? And if not, isn't there a danger that some people would just depend on that public job forever and that would relieve them of any duty to go out in the private sector and get a real job?

And I am reminded of the CETA program and all kinds of public programs that were—that didn't do very much good. Could you comment on that?

Ms. O'BEIRNE. Let me hasten to say, Mr. McCrery, that would not be my ideal welfare system but it strikes me that the Personal Responsibility Act, which is, of course, the subject of the hearing, is on the right track with respect to work obligations, not public-sector jobs, but community work which as you know, CETA was different.

I would be happy to talk to you at some time about the difference between those two, and about the focus on illegitimacy and spending in the States.

My ideal system would be look much closer to your own. The key part of my ideal system is that it would be funded at the State level. Governors would raise moneys locally to fund whatever welfare system a given State might want to design.

And if it looked—I suspect given the need for local support for welfare spending, it would look a lot closer to your system certainly than the status quo. So I think longer term, Washington, D.C., simply has to get out of this business of even raising these moneys in the name of helping low-income Americans.

Mr. MCCRERY. Well, to try to make it more clear; on the subject of public jobs, I am still not clear as to your position on that, and you know, there is a lot of talk about workfare and how do we move people from welfare to work and all that and that is a complex problem, but if our solution is to simply move them from doing nothing into a—into a make-work public job, then what have we accomplished? I have serious doubts that we have accomplished much of anything.

Ms. O'BEIRNE. I would agree. The end goal to which we must be striving cannot be a public-sector job. I would be happy to share with you some——

Mr. MCCRERY. Can it be an intermediate goal, though, for the next 50 years? That is what we often have happen with these Federal programs, we create them and then they just last forever.

Ms. O'BEIRNE. Self-sufficient in the private sector. For the purposes of the Personal Responsibility Act, though, I will share with you some material we have about the relative success of things that look a lot closer to what Governor Tommy Thompson does in Wisconsin than, for instance, the administration proposal which really are public-sector jobs where you have to pay union scale wages, and you can't take an available job.

For instance, absent fathers who have been identified and don't pay child support paint benches in Wisconsin, Governor Thompson's "pay or paint" proposal. That kind of community work for failure to meet a child support obligation has had a terrific effect, as you know, if you are familiar with the data from Wisconsin, in helping fathers meet their obligations. But I would be happy to share some of the data we have from counties about—not the public-sector model in the administration bill but community-oriented work in exchange for benefits.

Mr. MCCRERY. Thank you for drawing that distinction.

Thank you, Mr. Chairman.

Mr. BUNNING [presiding]. Mr. McDermott.

Mr. MCDERMOTT. Yes. Thank you, Mr. Chairman.

I am much more reassured after listening to both Mr. Shaw and Mrs. Johnson tell me that there will be no cut in the welfare money nor in the money for public assistance that is going out in the budget which is going to be proposed, but I would like to ask a hypothetical question, Ms. O'Beirne.

If a Governor received less money than he gets now for public assistance in his or her State, and it is in the form of a block grant to cover three or four or five different programs, one of which is AFDC, and if he had a requirement in the Federal law that he couldn't give money to mothers where paternity had not been established, what would be the incentive for a Governor to aggressively pursue establishing paternity if he could avoid the cost of paying the benefits if he wasn't able to?

Ms. O'BEIRNE. Well, if I understand your hypothetical, the prohibition would be on the use of Federal moneys in that situation——

Mr. MCDERMOTT. Yes.

Ms. O'BEIRNE [continuing]. Is presumably how the obligation would go.

Mr. MCDERMOTT. You are assuming there would be no commingling, as there presently is, between State and Federal money.

Ms. O'BEIRNE. Yes, I am assuming that. I am assuming that in order to provide Governors maximum flexibility, there will no longer be a State maintenance of effort. States will be free to use their current welfare spending, some $90 billion, I guess, which is currently spent pursuant to matching Federal programs. If that restriction were lifted, the Governors would also have another $90 billion broadly available to meet the needs of low-income citizens in their State no longer dictated by program requirements out of Washington.

That gives, it seems to me, the Governor an awful lot of flexibility with prioritizing where he thinks the need is greatest, where he thinks the funds in order to help very young mothers with children might be best spent. That is a whole——

Mr. MCDERMOTT. So if you didn't want to punish the illegitimate children, he would be able to use State money—as long as we didn't prohibit State money to be used he could use his State money to deal with it.

Ms. O'BEIRNE. I would so design such a proposition because I don't believe Washington should be in the business of prohibiting uses of State moneys. And then the Governor would be—which is how the system should work—fully accountable for raising those moneys and fully accountable for the use of such moneys and perfectly free——

Mr. MCDERMOTT. But essentially what you are doing then is washing the Federal Government's hands of any responsibility for a child born out of wedlock.

Ms. O'BEIRNE. No, that is not certainly how I would characterize what I am saying. What I am saying is the Federal Government, it seems to me, would be saying we have had certain policies in place over the past 30 years that we now recognize have been a disaster in the lives of women and children.

We have learned something. We have learned it is not a smart idea to give direct benefits to the 16 year old on the condition that she has a child without being married. We have stopped doing that with Federal money. We have learned.

Governors, if you want to continue that policy with State moneys, notwithstanding the experience we have had, you are free to, but we are now saying no longer Federal money, as I said, having learned some things at the Federal level.

Mr. MCDERMOTT. So you are basically saying that if the Governors fail to do anything about these kids, you don't care. I mean, you are saying that I, as a Congressman, should vote and my colleagues should vote for a proposal that would say that if the Governor doesn't take care of those kids, it is not my problem. That is basically what you are giving us, is giving us a kind of carte blanche to walk away from those kids.

Ms. O'BEIRNE. No, I am not, because——

Mr. MCDERMOTT. Well, then we are going to have to require the State to do something about that.

Ms. O'BEIRNE. Dr. McDermott, we have very different views. I believe that there are people at the State level every bit as compassionate and intelligent and committed as people in this room, to helping low-income Americans.

Mr. MCDERMOTT. I would suggest to you that the reason we have this program is because that was just not happening.

Ms. O'BEIRNE. Well, if that was the case in 1965——

Mr. MCDERMOTT. The reason we got to this program was because the States were not dealing with it. It didn't come up because they came up here and begged us. We looked out there and saw the problem of the unevenness of what went on in Wisconsin versus what went on in some other State and we said, this isn't right. We have to do something so everybody gets taken care of.

So we can't—I mean, you are saying we have to trust the States and I——

Ms. O'BEIRNE. I do.

Mr. MCDERMOTT [continuing]. Think that is the basis of your proposal.

Ms. O'BEIRNE. I think that is what the system is all about, and I do trust the States to have the same wisdom and compassion we have.

Mr. MCDERMOTT. I disagree.

Mr. BUNNING. Thank you very much, panel. We appreciate your testimony.

[The following was subsequently received:]

JON CHRISTENSEN
2D DISTRICT, NEBRASKA

Congress of the United States
House of Representatives
Washington, DC 20515-2702

January 11, 1995

Chairman Bill Archer
House of Representatives
Committee on Ways and Means
1102 Longworth H.O.B.
Washington, D.C. 20515

Dear Mr. Chairman:

I submit the following articles to be included in the record for the January 11, 1995, Ways and Means Committee overview hearing on the Contract with America.

Sincerely,

Jon

Jon Christensen

National Center for Policy Analysis

BRIEF ANALYSIS
No. 137
For immediate release:
Wednesday, October 26, 1994

The Case for a Capital Gains Tax Cut

The 1986 Tax Reform Act increased the maximum tax rate on capital gains income from 20 percent to 28 percent. This 40 percent tax hike has reduced government revenues, discouraged entrepreneurship and caused many investors to hold on to assets they would prefer to sell.

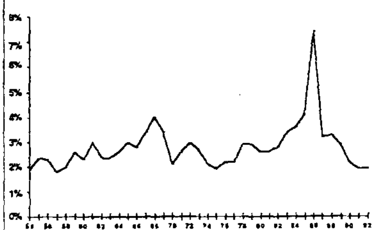
As a result, support for change is growing. On September 27, 1994, every Republican candidate for the House of Representatives signed a "contract" that proposes indexing capital gains for inflation and effectively cutting the capital gains tax rate in half for all taxpayers. Similar reforms are supported by many Democrats and such business organizations as the U.S. Chamber of Commerce. Let's see why.

The Case for Indexing. Because tax brackets and the personal exemption are indexed to inflation, people who receive wage income cannot be pushed into a higher tax bracket by the effects of inflation alone. No similar protection exists for those who receive investment income.

Because investors must pay taxes on gains that merely reflect the effects of inflation, the effective tax rate on their real gains can be extraordinarily high. For example, someone who invested in common stock in 1970, did as well as the Dow Jones Industrial Average and sold the stock in 1980 would have had a capital gain of 18.4 percent. During this same period the price level more than doubled, so the nominal gain actually represented a real loss of 44 percent. Nevertheless, the investor would have been assessed a capital gains tax. The purpose of indexing is to ensure that only real gains are taxed.

FIGURE I

Capital Gains Realizations as a Percent of GDP



Source: Congressional Budget Office and Internal Revenue Service.

The Case for Lower Tax Rates. The vast majority of assets have value only because they are expected to produce future income. For example, bonds will produce interest income and stocks will produce dividends and retained earnings. Since this income will be taxed as it is realized, there is no need to tax the owners of these assets at the time the assets are bought and sold. It impedes the efficient transfer of assets from those who value them less to those who value them more, and it makes investments in all income-producing assets less attractive.

Economic Effect: "Unlocking" Investments. The current taxation of inflationary gains, together with high statutory capital gains tax rates, creates a powerful "lock-in" effect. Since selling is taxed and possessing is not, high capital gains taxes encourage investors to hold rather than sell — thereby avoiding the tax indefinitely. Assets that are held until death avoid capital gains taxes altogether.

When investors lock in their assets this way, government loses revenue it would have gotten if tax rates were lower, and the capital market loses efficiency because the flow of assets to those who value them the most is impeded.

Economic Effect: More Revenue for Government. Capital gains are realized at the time assets are sold. It is clear from the history of asset sales that investors are highly sensitive to the tax on capital gains. As Figure I illustrates, investors rushed to sell assets in advance of increases in the capital gains tax in 1969 and 1987. This led to a bulge in sales in 1968 and again in 1986. After the tax increase, however, asset sales fell. Conversely, cuts in the capital gains tax in 1978 and 1981 led to increased sales, as the lock-in effect abated.

This history has been repeatedly ignored in Washington, DC. In 1986, the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) misled many members of Congress by predicting that the increase in the maximum capital gains tax rate from 20 percent to 28 percent would not deter asset sales and would increase government revenues. In fact:

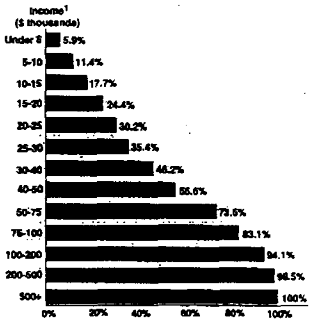
- Capital gains realizations in 1992 (the latest year for which statistics are available) were $116.5 billion, far lower than the $165.5 billion in 1985.
- At 40 percent higher tax rates, capital gains tax revenue of $26.8 billion in 1992 was about 13 percent higher than the $23.7 billion collected in 1985, but after adjusting for inflation, the collections represented a 13 percent decrease.

Economic Effect: More Investment. Capital gains taxes affect investment decisions. In particular, they reduce the amount of capital available for investments with higher risk potential, such as new start-ups and companies in emerging sectors. As a result, the capital gains tax tends to be a direct tax on the entrepreneurship that all economists recognize as essential to growth.

Economic Effect: Benefits for All Income Groups. Despite the strong evidence that lower capital gains tax rates buoy the economy, many in Congress continue to resist cutting the rate for fear they will be accused of cutting taxes only for the wealthy. Yet, as Figure II illustrates, the bulk of taxpayers realizing capital gains are those with middle incomes.

FIGURE II

Cumulative Percentage of Taxpayers Reporting Capital Gains in 1992



[1] Adjusted Gross Income.

Source: Internal Revenue Service.

- Well over half of all taxpayers with capital gains in 1992 had adjusted gross incomes of less than $50,000.
- More than 73 percent had incomes of less than $75,000.

Economic Effect: Economic Growth. All Americans would benefit from the stronger economic growth that would result from lower taxes on capital gains. Earlier this year a study by the Institute for Policy Innovation predicted that:

- A 50 percent capital gains exclusion (effectively cutting the tax rate in half) plus prospective inflation indexing would lower the cost of capital by 5 percent, thereby inducing investors to increase the capital stock by $2.2 trillion by the year 2000.
- This larger stock of capital would create 721,000 new jobs and increase total GDP cumulatively by almost $1 trillion by the year 2000.

Financing the Tax Cut. Expansion of economic activity would increase the overall tax base of the economy by more than enough to compensate for any loss in federal revenue from the tax changes described above. Indeed, the indexing feature alone is probably enough to ensure that the proposal increases revenue. Since only new investments would be indexed, most taxpayers would want to realize their existing gains and invest in new inflation-indexed assets.

This Brief Analysis was prepared by NCPA Senior Fellow Bruce Bartlett, an economist at the Alexis de Tocqueville Institution.

National Center for Policy Analysis

BRIEF ANALYSIS
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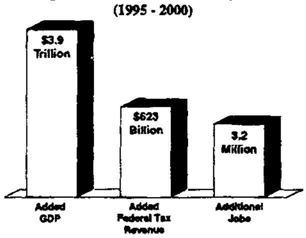
The Republicans' Pro-Growth Contract

The partisan battle over the Republicans' "Contract With America" has obscured the fact that at least six of the contracts proposals would, if enacted, stimulate economic growth. [See Figure I.]

- Cumulatively, the six pro-growth measures would increase Gross Domestic Product (GDP) by $3.9 trillion by the end of the decade.
- They would create an additional 3.2 million jobs over the next five years.
- They would raise $623 billion in additional federal revenue during the same period.

The additional revenue would be more than enough to pay for the contract's other proposals — including a $500 per child tax credit and removal of the marriage penalty — and would go a long way toward achieving a balanced budget with no increase in spending.

FIGURE I
Economic Effects of the Republican Pro-Growth Proposals[1]
(1995 - 2000)



[1] Excludes balanced budget amendment and other spending cuts.
Source: TaxAction Analysis.

Although the six proposals come from Republicans, most have also attracted support from many Democrats. Let's see why.

Expanded Individual Retirement Accounts (IRAs). The Tax Reform Act of 1986 limited tax-free IRA contributions to people with no employer-provided pension and those with incomes less than $25,000 for individuals and $40,000 for couples. As a result, we have a lower national savings rate. When Secretary of the Treasury Lloyd Bentsen was a senator, he cosponsored a bill to restore the right of every American to contribute up to $2,000 a year to an IRA. Senator John Breaux (D-LA) is another prominent Democrat who favors the idea.

These proposals would create a "backended" IRA option, under which IRA deposits would be made with aftertax dollars, but withdrawals at retirement would be tax free. This is important because middle-income Americans can expect to face higher marginal tax rates during retirement than during their working years.

Previous NCPA studies have shown that IRAs do not reduce government revenue. Instead, they result in additional investment, which results in additional output, which results in additional taxable income. Not only would the IRA proposal not cost the government any revenue, but it would increase federal tax revenue by an estimated $50 billion between 1995 and 2000 — even without any new savings — because it would induce people to pay taxes on their current IRA deposits in order to switch to a backended account.

Reducing the Capital Gains Tax. Because the tax brackets are indexed, wage earners cannot be pushed into a higher tax bracket by the effects of inflation alone. However, savers have no comparable protection. People who sell assets are forced to pay taxes on inflation-created profits, even if there has been no real profit.

To correct this defect in the tax law, the contract proposes excluding 50 percent of capital gains from taxation and indexing capital gains for inflation. Previous NCPA studies have shown that almost any capital gains tax rate reduction would produce more revenue when the effects of increased investment are taken into account.

Neutral Cost Recovery. The tax code also fails to index the depreciation of productive assets in order to allow for their replacement. If inflation averages, say, 5 percent per year, a company must spend 50 percent more to replace a machine after eight years. This means the company must earn additional income and pay additional taxes equal to about one-fourth of the replacement cost.

The contract proposes that businesses be allowed to increase their depreciation expenses each year for investments in plant and equipment to compensate for the effects of inflation and the time value of money. It also increases the amount of assets that could be expensed from $17,500 to $25,000, thus helping small businesses.

Reducing the Social Security Benefits Tax. Before 1993, Social Security recipients above a certain income level were taxed on half of their benefits. In 1993, the taxable amount was raised to 85 percent for single people with $34,000 or more and married couples with $44,000 or more in income. As a result, elderly taxpayers in the 28 percent bracket now face a marginal tax rate of 51.8 percent (28% x 1.85). The contract would phase out the 1993 changes, dropping it back to 50 percent by 1999.

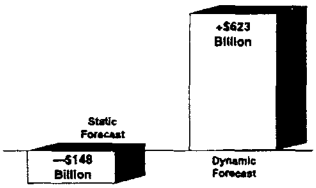
The Social Security benefits tax is mainly a tax on investment income. No tax is paid unless a taxpayer's income reaches a certain level. Beyond that point, the tax rises as income rises. Since 85 cents of benefits is taxed for each additional $1 of income, elderly taxpayers pay taxes on $1.85 for each additional dollar of income.

Increasing the Social Security Earnings Limit. Under this proposal, people between the ages of 65 and 70 who receive Social Security benefits could earn up to $30,000 without penalty in 1995. Currently, if they earn more than $11,160 in a year, they lose one dollar in benefits for every three dollars in earnings. This 33 percent tax rate makes the total marginal tax rate more than 100 percent for some older workers.

Raising the amount that retirees can earn without loss of benefits would expand the supply of elderly workers, help employers meet their demands for skilled labor over the next decade and increase federal revenue. If the earnings limit were completely abolished, the federal government would still make a small profit as additional work-related taxes more than offset increased benefit payments.

FIGURE II

Projected Impact of Proposals on Government Revenue (1995 - 2000)



Source: Congressional Budget Office, TaxAction Analysis.

Raising the earnings limit would increase federal outlays for Social Security benefits by $6.8 billion between 1995 and 2000, but higher economic growth created by the move would generate an extra $15 billion in federal revenue.

Increasing the Estate Tax Credit. The first $600,000 of an estate has been excluded from tax since 1987. As incomes and asset values have risen, it has become more likely that the tax would reach the estates of middle-income taxpayers. The contract would increase the exclusion to $750,000 in 1995 and index it for inflation thereafter.

Net Economic Effects. If increased investment is ignored, the Congressional Budget Office predicts that making all the tax cuts the contract calls for would reduce federal revenue by $150 billion over five years. [See Figure II.] However, NCPA Senior Fellows Gary Robbins and Aldona Robbins have calculated the dynamic — as opposed to static — effects in a study for TaxAction Analysis and have concluded that the measures would add 2 percentage points to our annual growth rate, resulting in a higher GDP, more jobs and more tax revenue.

Mr. MCDERMOTT. The next panel, Paul Beckner, David Keating, J.D. Foster, Iris Lav.

Chairman ARCHER [presiding]. Mr. Beckner, if you will proceed.

STATEMENT OF PAUL BECKNER, PRESIDENT, CITIZENS FOR A SOUND ECONOMY FOUNDATION

Mr. BECKNER. Thank you.

Good afternoon, Mr. Chairman.

My name is Paul Beckner and I am president of Citizens for a Sound Economy Foundation, a nonpartisan research and education organization formed in 1984 to study and develop market-based solutions to public policy problems. Our 250,000 members have worked long and hard to reverse the trend of ever-higher tax burdens and government spending.

I want to thank you for the opportunity to address this committee on the very important issues of welfare reform and tax reform outlined in the Contract With America.

I would like to start with the subject of welfare reform, and what I want to talk to you about today is a national survey that CSE Foundation conducted in December, of 1,000 middle-income American voters earning between $20,000 and $60,000 per year.

If you will bear with me for a few minutes, I want to go into a fair amount of detail on the results, because I believe that what the American people are saying about welfare reform provides a sound blueprint for welfare reform.

Middle-class Americans believe our welfare system is a failure because it does little to promote self-sufficiency and any reform of the system should include a requirement that welfare recipients work for their benefits. Notably, two out of three surveyed who themselves have been on welfare or who know someone who has been on welfare, want a tough love approach to welfare.

These Americans don't think reform means having to spend more money nor do they think it means raising taxes to pay for reform. The middle class want those who benefit from the taxpayers' generosity to contribute more to their own well-being.

Our survey found that an overwhelming majority of middle-class voters, 93 percent, believe able-bodied welfare recipients should be required to work at least part time in a community job while they receive benefits. A slight majority, 53 percent, think able-bodied individuals on welfare should be given 1 year or less to find a job. Just 12 percent believe welfare recipients should be given 2 or more years to find work. And 80 percent of middle-class voters were supportive of giving a tax credit to businesses hiring welfare recipients.

Seventy-nine percent of the middle-class voters polled support requiring mothers to identify a child's father in order to receive welfare assistance, and 61 percent support a requirement that teenage mothers live at home with their families in order to receive benefits.

On the other hand, 57 percent of those surveyed would oppose denying benefits for women under 18 who have children. While only 15 percent of middle-class voters favor current regulations that allow women on welfare to increase their family's benefits when she has additional children, 77 percent oppose moving children from welfare families to group homes or orphanages.

By a 59-to-39 percent margin, middle-class voters oppose increasing taxes on such items as cigarettes, alcohol, or gasoline to fund welfare reform. An even larger majority, 82 percent, favor handing over the responsibility for running welfare programs to State and local governments.

The middle class is telling policymakers in Washington that the days of welfare assistance without limits are over. They want policies that require people to work in order to receive assistance, to have teen mothers remain with their parents, and the father of a child be identified so he can be held accountable. What middle-class voters want are incentives to have people be responsible for their own actions and to get off welfare as quickly as possible.

Let me turn very briefly to the subject of tax reform. Tax reform is another top concern to CSE Foundation's 250,000 members. Today, the typical American family pays more in total taxes than it spends on food, clothing and shelter combined. If the elections on November 8 mean anything, it meant that the time is ripe to completely revamp the Federal income tax system.

Not only is there a genuine recognition that the tax burden on all income groups is at a record high, but just complying with our complex tax system requires nearly 6 billion man-hours and costs more than $192 billion per year. If this time was spent on productive work, it would represent the entire annual outputs of the U.S. auto, truck, and aircraft industries.

The major tax relief items outlined in the Contract With America recommends a welcome and needed step in reversing the growing tax burden on the middle class and small business. I urge you to quickly implement the major Contract items that include a $500-per-child tax credit, repealing the 1993 tax hikes on Social Security recipients, expanding IRAs, and reducing the punitive tax burden currently levied on capital gains.

These items alone would go a long way toward allowing individuals to keep a greater share of their hard-earned money. However, while these tax relief items would provide needed relief, a more comprehensive tax reform agenda should also be considered for the longer term.

Efforts to achieve true tax reform goals will undoubtedly strike up a chorus of naysayers who believe it can't be done and will draw attacks from those who benefit from the status quo. However, the Contract, and proposals like the flat tax plan introduced by Congressman Dick Armey, can accomplish these goals and deserve serious attention in the 104th Congress.

I appreciate this opportunity to testify this afternoon on tax reform and welfare reform, and I look forward to working with you in the months and years ahead to enact policies that will enhance economic growth and improve the standard of living for all Americans, and I will be happy to answer any questions you have.

Thank you.

[The prepared statement follows:]

Statement of

Paul Beckner
President

Citizens for a Sound Economy Foundation

before the

Committee on Ways and Means
United States House of Representatives

on

Tax and Welfare Reforms and the Contract With America

January 11, 1995

Good morning Mr. Chairman. My name is Paul Beckner, and I am President of Citizens for a Sound Economy Foundation, a nonpartisan research and education organization formed in 1984 to study and develop market-based solutions to public policy problems. Our 250,000 members have worked long and hard to help reverse the trend of ever-higher tax burdens and government spending. I want to thank you for the opportunity to address this committee on the very important issues of welfare reform and tax reform outlined in the Contract With America.

Welfare Reform

Though one recent Wall Street Journal/NBC News poll showed that the electorate's top congressional priority is welfare reform (beating out health reform, a balanced budget amendment, and even a middle-class tax cut), President Clinton has failed to make good on his popular promise to "end welfare as we know it." And, there is little, if any, consensus among lawmakers on the numerous and diverse proposals currently aimed at reforming our welfare system.

However, the broad middle-class, those who pay the bulk of the tab for social programs like welfare, do know quite clearly just how they would want to see welfare reformed. Lawmakers can and should take the advice of the middle-class when making the tough decisions needed to accomplish genuine welfare reform.

Middle-class Americans - those earning between $20,000 and $60,000 a year, believe our welfare system is a failure because it does little to promote self-sufficiency, and any reform of the system should include a requirement that welfare recipients work for their benefits. These and other attitudes of the middle-class on this issue were documented by a national survey of middle-class voters commissioned last month by Citizens for a Sound Economy Foundation.

Interestingly, these middle-class voters -- two out of three who themselves had been on welfare or knew someone who has been on welfare -- want a 'tough love' approach to welfare. These Americans don't think reform means having to spend more money. Nor do they think it means raising taxes to pay for reform. The middle-class want those who benefit from the taxpayers' generosity to contribute more to their own well-being.

I'd like to summarize some of our survey's findings. Seventy-eight percent of those asked agreed that "the current welfare system is a failure because it encourages long-term dependency on the government and does little to promote self-sufficiency." Only 17 percent of those asked believed the welfare system "is a success because it provides a safety net for less fortunate Americans until they can get back on their feet."

An overwhelming majority of middle-class voters - 93 percent - believe able-bodied welfare recipients should be required to work at least part-time in a community job while they receive benefits. A slight majority - 53 percent - think able-bodied individuals on welfare should be given one year or less to find a job; just 12 percent believe welfare recipients should be given two or more years to find work. And 80 percent of middle-class voters were supportive of giving a tax credit to businesses hiring welfare recipients.

Seventy-nine percent of the middle-class voters polled support requiring mothers to identify a child's father in order to receive welfare assistance, and 61 percent support a requirement that teenaged mothers live at home with their families in order to receive benefits. On the other hand, 57 percent of those surveyed would oppose denying benefits for women under 18 who have children. While only 15 percent of middle-class voters favor current regulations that allow a woman on welfare to increase her family's benefits when she has additional children, 77 percent oppose moving children from welfare families to group homes or orphanages.

By a 59 to 39 percent margin, middle-class voters oppose increasing taxes on such items as cigarettes, alcohol or gasoline to fund welfare reform. An even larger majority - 82 percent - favor handing over the responsibility for running welfare programs to state and local governments.

The middle-class is telling policymakers in Washington that the days of welfare assistance without limits are over. They want policies that require people to work in order to receive assistance, to have teen mothers remain with their parents, and the father of a child be identified so he can be held accountable. What middle-class voters want are incentives to have people be responsible for their own actions and to get off welfare as quickly as they can.

Based on our survey results, here's how the middle-class's welfare reform plan would look:

1. **The problem** is not so much that payments and benefits going to welfare recipients are too high, rather, the incentives are such that people are on welfare too long, and it has become a way of life.

2. **The role of government** cannot be one of guaranteeing the financial well-being of every able-bodied citizen -- otherwise we will never be able to reform the welfare system. The middle-class's reform plan can best be described, as I said before, as a "tough love" approach where recipients become more responsible for their own actions.

3. **No new spending** should be required for welfare reform. The money now being spent on welfare should be spent differently to reduce the size and scope of federal programs.

4. **No new taxes** are necessary for reform either. More than one-third surveyed stated that welfare reform means that fewer tax dollars should be spent on welfare, and nearly twice as many said increasing taxes on such items as alcohol, cigarettes, and gasoline to finance any reforms was unacceptable.

5. **Keeping families together** is an important goal. The middle-class overwhelmingly opposes the concept of moving children from welfare families to orphanages or group homes, and supports requiring teenaged mothers to live at home with their families in order to receive benefits.

6. **Compassion with incentives** means women on welfare who have additional children should not have their benefits cut off. However, their benefits should not rise with each additional child as they do currently. The middle-class does not favor disallowing benefits for women under 21 who have children, but a mother should be required to establish the identity of the father of her child before receiving any welfare benefits.

7. **Time limits on benefits** will restrict how long able-bodied individuals should receive benefits before they are required to find a job. While eight of 10 middle-class voters surveyed prefer not more than two years as a limit, a majority would be even tougher by putting a one-year limit on benefits.

8. Work tied to benefits would require able-bodied people receiving welfare payments to work full- or part-time in a community service or other available job while they receive benefits. Businesses should be given a tax incentive for hiring welfare recipients.

9. State and local governments are best suited and better able manage welfare programs. It is a good idea to consolidate the many different federal poverty programs and allow those resources to be used in state and local welfare systems.

Hopefully, the reform parameters outlined by the middle-class will provide lawmakers with a realistic and solid guide for transforming our welfare system. The Contract With America's Personal Responsiblity Act is consistent with the broad views of the middle-class by calling for welfare savings, spending caps, consolidation of several programs into block grants, and limiting eligibility.

Tax Reform

Tax reform is another top concern of CSEF's 250,000 members. Today, the typical American family pays more in total taxes than it spends on food, clothing and shelter combined. If the elections on November 8 meant anything it meant that the time is ripe to completely revamp the federal income tax system. Not only is there a genuine recognition that the tax burden on all income groups is at a record high, but just complying with our ultra-complex tax system requires nearly 6 billion man hours each year and costs more than $192 billion. If this time was spent on productive work, it would represent the entire annual outputs of the U.S. auto, truck, and aircraft industries.

After seven decades of abuse by lawmakers, lobbyists, special interests, and self-righteous income redistributors, our tax code is a dangerous mess. People have been taxed retroactively without recourse. Marginal income tax rates that were 15% and 28% just a few years ago now are as high as 45 percent. These high tax rates combine with double and even triple taxation of income to stifle work effort, discourage savings, retard innovation, and foster unproductive investments in tax shelters. All told, the current income tax system needlessly hinders our nation's productivity and reduces every American's standard of living.

The major tax relief items outlined in the Contract With America represent a welcomed and needed step in reversing the growing tax burden on the middle-class and small business. While middle-class taxpayers were promised relief a few years ago, they have instead absorbed new tax increases levied on gasoline, small business owners, and Social Security recipients. Therefore, the tax relief items in the Contract With America would help reverse the increased tax burdens recently levied on the beleaguered middle-class taxpayer.

I urge you to quickly implement the major Contract items that include a $500 per child tax credit, repealing the 1993 tax hikes on Social Security recipients, expanding IRAs, and reducing the punitive tax burden currently levied on capital gains. These items alone would go a long way toward allowing individuals to keep a greater share of their hard earned money and would encourage greater work effort, saving, and investment that would help boost economic growth and our standard of living.

However, while these tax relief items would provide needed relief, a more comprehensive tax reform agenda should also be considered for the longer term. Short of repealing the 16th Amendment passed in 1913 that allowed Congress to "tax income from whatever source derived," how can real tax reform be achieved? What are the most important goals?

First and foremost, any real tax reform must not involve the addition of new forms of taxation on top of the existing tax structure. Much talk, on both sides of the political aisle, has been spent on completely replacing the income tax with some form of a National Sales Tax, Value Added Tax, or other "consumption"-type tax. Realistically, a replacement for the income tax is a farce unless the 16th Amendment is gone. Otherwise, any so-called replacement tax becomes a new "add-on" tax that would only increase the level of complexity within the tax system and undoubtedly would lead to an even higher tax burden.

In addition to simplifying the tax code, tax reform should seek to reduce the record-high tax burden across the board--not simply shifting the tax liability among income groups. Tax reform should involve real tax relief. It's now time to end the "rich" vs. "poor" tax warfare that has prevailed to the disadvantage of all taxpayers.

The destructively high marginal income tax rates that discourage working, saving, and investing need to be dramatically reduced. These high marginal tax rates need to be cut in order to foster long-term economic growth and to improve investment, productivity, and the overall standard of living. Reducing high marginal tax rates worked when President Kennedy did it in the 1960s and for President Reagan in the 1980s, resulting in two periods of our most vigorous economic growth.

Relief must be provided from the double and even triple taxation of savings and investment that continues to hinder our rate of savings. The indexation of capital gains and expanding the use of IRA accounts outlined in the Contract is a good start. These new savings are critically needed for new investment that all economists agree is necessary to create more jobs and increases wages.

Moreover, any tax reform needs to honestly address and reduce the record-high burden of payroll taxes. Commonly referred to as Social Security taxes, most American families now pay more for these Social Security payroll taxes than they do in income taxes. Meaningful "middle-class" tax relief cannot ignore the burden of Social Security taxes. Too often in recent years, the mushrooming spending growth on Social Security programs has been largely addressed by simple increasing payroll tax rates and levying additional taxes on beneficiaries rather than controlling spending.

These Social Security taxes are an especially bad deal for current taxpayers because their projected rate of return is far less than they could get under a private savings arrangement. Worse yet, these tax liabilities will increase as spending levels on associated entitlement programs continue to mushroom. Therefore, any comprehensive tax reform must be tied to reducing the growth rate of entitlement spending. Tax reform should allow individuals the flexibility to save for their own retirement, health care, and other needs to avoid forced dependency on financially floundering government entitlement programs.

Efforts to achieve these true tax reform goals will undoubtedly strike up the chorus of naysayers who believe it can't be done and will draw attacks from those who benefit from the status quo. However, bold proposals like the flat tax plan introduced by Rep. Dick Armey (R-TX) can accomplish these goals and deserves serious attention in a re-energized 104th Congress.

I greatly appreciate this opportunity to present CSEF's ideas on tax and welfare reforms before this committee. I look forward to working with you in the months and years ahead to enact policies that will enhance economic growth and improve the standard of living for all Americans. I will be happy to answer any questions you may have.

Mr. BUNNING. Thank you.
Mr. Keating.

STATEMENT OF DAVID KEATING, EXECUTIVE VICE PRESIDENT, NATIONAL TAXPAYERS UNION

Mr. KEATING. Thank you, Mr. Chairman and members of the committee for the invitation to appear today.

I appear on behalf of the 250,000 members of the National Taxpayers Union, and we fully support the tax reduction concepts contained in the Contract With America. It is equally important that the spending cuts pledged by that Contract be enacted, because if they aren't, the tax relief will be temporary at best.

Using the spending cuts to finance the $500-per-child tax credit demonstrates one of the fundamental principles of the Contract, and that is to increase the choices of the American people. Fewer choices would be made by elected officials and bureaucrats, because the money would go back into the hands of the American family. Not only would this lead to less government waste and inefficiency, it would strengthen the American family, which is so essential to improving our children's futures.

We are especially enthusiastic about the American dream savings accounts, which would allow families to contribute up to $4,000 annually into a special savings account. Now, most people have talked about the tax reduction aspects of these accounts and how that could increase savings. Equally important is that these savings accounts will lead to a new blizzard of advertising each year that will help change the culture in America to one of savings and investment.

When the fully tax-deductible IRA disappeared, so did the annual advertising blitz urging people to save for their retirement. With American dream savings accounts, I think we would again see national advertising by banks, thrifts, mutual funds, and others teaching people the virtues and rewards of saving for the future.

We are also particularly enthusiastic about the proposed indexation of the capital gains tax. As you may know, our organization worked very hard in 1981 for indexing the tax rate structure of the personal income tax, and we think it is long overdue to index the capital gains tax for inflation. It is not uncommon for taxpayers to pay over a 100 percent tax rate on real gains after the costs of inflation are considered.

I would also like to make two other suggestions about capital gains. It would be far preferable to have a capital gains rollover provision. If you take the money from the sale of one asset and invest it in another asset, you really haven't made any income at all, you just switched your investment strategy. We allow a rollover right now for owner-occupied housing, which is probably the least important in terms of the economic effect of a rollover provision.

You may also want to look at ways to reduce the lock-in effect on capital gains for elderly taxpayers. It really makes little, if any, tax sense for an elderly person to sell an asset, because at death the basis is stepped up. Perhaps you could offer a tax credit against estate taxes for any capital gains taxes paid within 10 years of death. That might reduce some of the lock-in effect on the investment strategies of the elderly.

My written statement goes into additional details of our views on other portions of the tax reductions contained in the Contract With America.

I do want to say one other thing and that is although we support these proposals, we are even more interested in a fundamental reform of the tax system. While some of the measures in the Contract With America will certainly make an important step to improving the fairness or efficiency of the Tax Code, we can get far greater benefit from an improved tax system by replacing it with, say, a flat rate income tax or replacing the income tax with a consumption tax.

Thank you very much for the opportunity to express our views this afternoon.

[The prepared statement follows:]

NATIONAL TAXPAYERS UNION

Statement of

David Keating
Executive Vice President
National Taxpayers Union

on

Tax Provisions in the Contract With America

before the

Committee on Ways and Means
U.S. House of Representatives

January 11, 1995

Mr. Chairman and Members of the Committee, thank you for the invitation to express our views on the tax provisions in the Contract With America. I appear on behalf of the 250,000 members of the National Taxpayers Union.

For 25 years, the National Taxpayers Union (NTU) has fought for lower taxing and spending, and welcomes the efforts in the 104th Congress to reduce both.

The legislation contained in the Contract With America outlines many tax reduction proposals that would help reduce the tax disincentives to savings, investment, job creation, wage increases and economic growth. Equally important, passage of this legislation would help improve the fairness of the tax laws.

These changes must also be viewed in the context of the pledge made in the Contract With America to reduce the deficit. Near the conclusion of the Contact, House Republican candidates made the following pledge:

> Further . . . we will work to enact additional budget savings, beyond the budget cuts specifically included in the legislation described above, to ensure that the Federal budget deficit will be less than it would have been without the enactment of these bills.

It is vitally important that the spending cuts pledged by the Contract be enacted. The true burden of government is not solely what the federal government collects in taxes, but what it spends. If the rate of spending increase is not reduced, then the tax relief promised in the Contract will prove to be temporary.

The American Dream Restoration Act

The Contract summary of the American Dream Restoration Act says it proposes a "$500 per child tax credit, [to] begin repeal of the marriage tax penalty, and creat[e] American Dream Savings Accounts to provide middle class tax relief."

Using spending cuts to finance the tax credit for children demonstrates one of the fundamental principles of the Contract -- to increase choices. This portion of the Contract proposes to reduce the spending choices made by elected officials and bureaucrats, while increasing the choices made by the average American family. Not only will this lead to less government waste and inefficiency, it will strengthen the American family, which is so essential to improving our children's futures. While not every family will make the best decision, overall the decisions about how to spend family resources are best made by each family; not by Washington.

We note that the tax credit is available only to families with annual incomes of $200,000 or less. One great weakness of the current tax law is that it contains many provisions to phase out the value of tax breaks, which causes hidden marginal tax rate increases over certain income ranges. We hope that the final language of this provision will minimize additional complexity or seek to minimize marginal tax rate increases at the income cut-off for this tax credit. The Committee may also wish to convert the current personal exemption for dependents to a tax credit, which may help reduce tax form complexity.

We are especially enthusiastic about the proposed American Dream Savings Account, which would allow families to contribute up to $4,000 annually into a special savings account. The deposit would not be tax deductible, but the withdrawal would be tax free, if certain conditions are met. This provision will be beneficial in a variety of ways.

First, it will add to the nation's pool of savings. Savings and investment rates in the United States are far below its key competitors. Our savings rate over the past twenty years is a mere 5.3%, barely one-quarter of Japan's 19.4%, and only one-half of Germany's 10.8%. American Dream Savings Accounts will help bolster our low savings rate.

While the tax reduction is the most obvious incentive for boosting the savings rate, few people have commented on the ability of such accounts to change cultural attitudes about savings. When the fully tax-deductible Individual Retirement Account disappeared, so did huge annual advertising campaigns that taught Americans the advantages of steady savings for retirement. The tax advantages of the American Dream Savings Accounts would likely lead to another annual blizzard of advertising on the benefits of savings. The power of this advertising should not be underestimated. In 1981, virtually every tax analyst drastically underestimated the number of taxpayers who would open an IRA.

Second, American Dream Savings Accounts will provide security for America's families. A recent paper by Neil Howe for the National Taxpayers Union Foundation showed conclusively that demographics over the coming decades will put a squeeze on the American economy and its ability to fund our current commitments to retirees under Social Security. To maintain our current system of Social Security, Medicaid and Medicare would require total tax rates on workers to climb from their current 41 percent to between 57 and 69 percent by 2040. Given this bleak scenario, it is wise to encourage American families to increase their savings because the benefits promised by current laws are not sustainable.

The Job Creation and Wage Enhancement Act.

There are many attractive features for small businesses in the Job Creation and Wage Enhancement Act. By expanding from $17,500 to $25,000 the amount that small businesses can deduct for investment in equipment and inventory, we will foster greater long-term growth in one of our most important economic sectors. This tax change is especially critical when we recognize that while two-thirds of all jobs created in the 1980's were in small business, nearly half of all small businesses fail within the first five years.

Proposing to cut the capital gains tax to 15% and adding indexation is one of the most pro-growth features of the entire Contract tax cut agenda. Capital gains taxes are detrimental to capital investment and economic growth. The high cost of capital has slowed economic growth and lessened our ability to compete internationally.

John Kennedy once said, "The tax on capital gains directly affects . . . the ease or difficulty experienced by new ventures in obtaining capital, and thereby the strength and potential for growth of the economy." Kennedy's insight about the inverse relationship between capital gains taxes and economic growth has been documented in numerous studies in recent years.

The National Center for Policy Analysis notes, "Higher capital gains taxes stifle investment and economic growth, reducing employment opportunities for all Americans -- particularly for the poor. Historically, entrepreneurial activity (which stimulates job creation) is lowest during periods of high capital gains tax rates and greatest during periods of low capital gains tax rates. For instance, there were 20 times more public stock offerings in 1983, when the capital gains tax rate was 20 percent than in 1978, the last year it was 49 percent. Lower capital gains taxes contributed to the creation of 20 million jobs during the 1980s."

And contrary to the myths being propagated in criticisms of capital gains tax reductions, the lower and middle income groups benefit as much as upper income groups. Beyond the job creation that benefits Americans of every income group, 68 percent of the tax returns showing capital gains in 1987 were from Americans earning $50,000 or less.

Indexation of the capital gains tax would greatly improve the fairness of the capital gains tax. It is not at all uncommon for taxpayers to pay effective capital gains tax rates of over 100%, after the costs of inflation and taxes are considered. Capital gains taxes are levied on the difference between the purchase and sales price of an asset. In many cases taxpayers have had to pay taxes on real losses due to fictitious gains caused by inflation.

The capital gains reduction may provide more economic growth for the dollar of tax cut than any other proposal in the Contract. The capital gains relief provisions could be improved by allowing a tax-free rollover of the proceeds from the sale of an asset. Such a provision is already available for owner-occupied housing. A rollover provision would end the problem of lock-in, where investors do not change their portfolio because of taxes.

Complete elimination of capital gains taxes, as has been suggested by Representatives David Dreier and Billy Tauzin, should also be seriously considered. Federal Reserve Chairman Alan Greenspan was one of the first to argue for a zero federal capital gains tax: "It is easier to make the case to eliminate it entirely than it is to merely reduce the rate . . . It is a direct tax on the nation's standard of living."

I suggest the Committee also consider methods to reduce the lock-in effect of capital gains taxes on investment decisions made by elderly taxpayers. The basis for bequeathed assets is stepped-up to the fair market at the date of death. An elderly taxpayer is thus unlikely to sell an appreciated asset, especially if the taxpayer's assets will be subject to estate taxes. One way to significantly reduce this lock-in effect would be to allow a tax credit against estate taxes for any capital gains taxes owed within ten years of death and paid in full.

Expanding the estate tax exemption from $600,000 to $750,000 will make a long overdue adjustment for inflation and help ensure that small businesses and family farms will stay in the family, instead of being sold to pay a tax bill.

Another significant change that will help taxpayers will be the changes proposed in the home office deduction. The Contract proposal would clarify the current deduction and allow taxpayers to qualify if their office is used exclusively for a business purpose, used on a regular basis, used to perform tasks that could not easily be performed elsewhere, and is essential to the taxpayer's business. The Contract's provisions would broaden the rules under which taxpayers could claim this deduction and end current, somewhat arbitrary exclusions of certain businesses from this provision.

Senior Citizens Equity Act

The Contract proposes repealing the 1993 change in the tax treatment of Social Security benefits, which increased the portion of Social Security benefits subject to taxation from 50% to 85%. While there is an argument to be made that Social Security benefits should be targeted to the elderly poor, the 85% rate is arbitrary and unfair. Another problem with the 1993 law's tax treatment of Social Security benefits is that it actually results in very high marginal tax rates on people who have saved for their retirement. We believe it would have been more fair to put these benefits on a similar footing as benefits paid by private pensions. Subject Social Security benefits to tax, but only to the extent that the benefits received exceed the taxes paid into the Social Security system. Going back to the pre-1993 law still results in an unfair and illogical tax treatment of Social Security.

Taxing only the excess of benefits received over taxes paid is much more fair and would dramatically increase public understanding of the system. Many elderly believe the myth, created by years of government propaganda, that they only receive benefits that represent a return of their Social Security taxes. Taxing only the benefits that exceed taxes paid would help correct this myth. Each Social Security recipient should receive an annual statement from the Social Security Administration showing lifetime benefits paid to date compared to lifetime taxes paid. Only the excess would be subject to tax.

Such a statement would probably increase the willingness of today's better-off retired elderly to accept restraints in Social Security benefit payments. They would clearly see that Social Security benefits far exceed the taxes they paid into the system. As a result, the tax treatment of the benefits would be perceived as being more fair.

The Contract also proposes to increase the Social Security earnings limit. While this limit functions in ways that are quite similar to taxes, it actually results in an increase in Social Security benefits and an increase in federal spending. We urge that any such increases in entitlement spending on Social Security be accompanied by reductions elsewhere in the program. Otherwise, such a change would move up the date for the coming bankruptcy of the Social Security system.

Conclusion

The National Taxpayers Union looks forward to working with this Committee and the entire 104th Congress to ensure that we enact real and meaningful tax and spending cuts. Just as importantly, should the Congress pass and the states ratify the Balanced Budget Amendment to the United States Constitution, the federal government will have to cut approximately $1.4 trillion in spending over the next seven years. Thus, we concur with the judgment of Senators Domenici, Packwood and others that the spending cuts we enact this spring should not merely be limited to those required to pay for these tax cuts. Congress should make substantial further spending cuts as a "down payment" on a balanced budget.

While we are supportive of the aforementioned efforts to lower the tax burden, I would also like to reiterate the support of the National Taxpayers Union for even more fundamental reform of the tax system. While some of the above measures will stimulate growth and provide needed tax relief to American families, the benefits from these provisions would pale in comparison to the economic benefits flowing from adoption of a flat rate income tax, such as the one proposed by Rep. Dick Armey. A flat rate income tax will free American individuals and businesses from the billions of hours they annually spend preparing taxes and remove huge disincentives to growth. It is one of the best ways we can prepare our nation to compete in the 21st century.

Mr. BUNNING. Thank you, Mr. Keating.
Chairman ARCHER. Dr. Foster.

STATEMENT OF J.D. FOSTER, PH.D., EXECUTIVE DIRECTOR AND CHIEF ECONOMIST, TAX FOUNDATION

Mr. FOSTER. Thank you, Mr. Chairman, members of the committee.

I appreciate the opportunity to address the committee, and I commend you for your ability to sit through these long hearings.

The Tax Foundation is a nonprofit, nonpartisan organization that has monitored fiscal policy at all levels of government since 1937.

The Tax Foundation is not a lobbying organization. We don't take positions on specific legislation. Our goal is to explain as precisely and clearly as we can the current state of fiscal policy and the consequences of particular legislation so that you, the policymakers, may make informed decisions.

The Tax Foundation's founding fathers set out certain principles of taxation to guide our analysis. Among these principles is that a good tax system should be simple. It should be easy to understand for the average taxpayer. It should not include retroactive tax provisions. It should be used solely to raise revenue, not micromanage the economy. It should not be continually rewritten and it should be implemented recognizing the competitive nature of the world economy.

In the recent elections, the American people, as interpreted by the press and this Congress, expressed a clear preference for lower taxes and less government.

One does not have to look far to find an explanation. Every year the Tax Foundation produces an analysis we call Tax Freedom Day. Imagine every dollar you earn going to pay Federal, State, and local taxes beginning January 1. Tax Freedom Day is the day when the average taxpayer's tax liability is paid off for the year, when the taxpayer is finally free to keep the money he or she earns. In 1994, Tax Freedom Day fell on May 5 which tied 1981 as the latest Tax Freedom Day in U.S. history.

Facing historically high tax burdens it is easy to see why taxpayers demanded relief. Yet it would be an extraordinary shame if the current effort to reduce taxes ignored some of our long-term economic problems as described in detail recently by the President's Entitlement Commission. Among these I would emphasize that we have an abysmally low savings rate, as Drs. Boskin and Bosworth mentioned in the earlier panel.

We have a very low private investment rate and the Federal deficit remains a problem even though we have made some progress recently. Since not all tax cuts will address those problems equally, I would like to offer a simple five-point checklist for choosing among the tax cuts under consideration.

First the tax cut package should not increase the budget deficit. That is clearly number one. Second, tax cuts for individuals should not be paid for by tax increases on businesses. Third, tax cuts for low- and middle-income taxpayers, however defined, should not be paid for by raising taxes on other citizens.

Fourth, whatever tax cuts are enacted, they should not make the tax system more complicated than it already is. And fifth, whatever tax cuts are enacted, even though passed relatively quickly, should not be chosen to meet short-term political goals, but should instead be designed to address the needs of a long-term policy consistent with sustained economic growth.

The current spate of proposed cuts should be developed as a near-term downpayment on a long-term program of fundamental tax reform.

What does a long-term program look like? The majority leader has a flat tax proposal. The minority leader is purported to have a plan. The chairman of this committee has expressed interest in major reform. Senators Domenici and Nunn have spent a couple of years now developing a very detailed tax reform plan.

But as the committee weighs its options, it will save itself and the taxpayers a lot of hardship if it keeps the future direction of tax reform in mind. And whatever reform you prefer at this point, it seems likely that capital gains relief, at least in the form of indexing, will be appropriate, and neutral cost recovery will be consistent with that reform, and that the improved IRA, called the American dream savings account, will also be consistent with future tax reform.

On the other hand, however well intentioned, a child tax credit and an adoption tax credit, if enacted, in the cuts of today seem less likely to survive the tax reform of tomorrow because they complicate the Tax Code without offering any offsetting benefits in terms of marginal tax rate reductions.

The Congress has embarked on a program of change in the role of government. Less is now perceived to be better than more. Yet, as in most things, some means of achieving the desired results are better than others. The five-point checklist may be a useful guide to making these decisions: Deficit neutrality, individual tax cuts without business tax increases or raising taxes on other individuals, avoiding complicating tax changes, and reducing the micromanagement of the economy through the Tax Code.

Finally, if the past election really was a call for less government and more freedom, then perhaps Tax Freedom Day itself provides a good measure of what is and should be accomplished. Tax Freedom Day in 1994 was May 5. Perhaps the Congress should decide how many additional days of tax freedom the American people really want. Was the recent election a call for 1 more day of tax freedom, for 1 week? That is what you have to decide and then having decided how much additional tax freedom the American taxpayer really wants, that then should be the guide to how far taxes and spending ought to be cut.

Thank you.

[The prepared statement follows:]

Statement of

J.D. Foster, Ph.D.
Executive Director and Chief Economist

Tax Foundation

on

The Contract With America and Tax Reform

January 11, 1994

Mr. Chairman and Members of the Committee, my name is J.D. Foster and I am the Executive Director and Chief Economist of the Tax Foundation. It is an honor for me to appear before your committee today on behalf of the Tax Foundation to discuss the "Contract with America" and the direction of tax policy.

The Tax Foundation is a non-profit, non-partisan research and public education organization that has been monitoring fiscal policy at all levels of government since 1937. We have approximately 600 members, consisting of large and small corporate and non-corporate businesses, charitable foundations, and individuals. Our business membership covers practically every region of the country and every industry category.

I would like to emphasize to the Committee that the Tax Foundation is not a "grass-roots" organization, a trade association, or a lobbying organization. We do not take positions on specific legislation or legislative proposals. Our goal is to explain as precisely and clearly as we can the current state of fiscal policy and the consequences of particular legislation in the light of the tax principles delineated above, so that you, the policy makers, may make informed decisions.

When it was established in the late 1930s, the Tax Foundation's founding fathers set out certain principles of taxation which the Tax Foundation would promote and which would guide our analysis of tax proposals. According to these principles, a good tax system should:

- Be as simple as possible -- complexity makes accurate tax compliance needlessly expensive and diminishes the public's willingness to comply with the law;
- Not be retroactive -- taxpayers must have confidence in the law as it exists entering into a transaction;
- Raise revenue, not micromanage the economy with subsidies and penalties;
- Not be continually rewritten -- frequent change lessens citizen understanding of the tax code and complicates long-term economic planning; and,
- Be implemented recognizing the competitive nature of the world economy.

In the recent election the American people, as interpreted by the press and this Congress, expressed a clear preference for lower taxes and less government. One does not have to look far to find an explanation. Every year the Tax Foundation produces an analysis we call Tax Freedom Day. Imagine every dollar you earn going to pay federal, state, and local taxes beginning January 1. Tax Freedom Day is the day when the average taxpayer's tax bill is paid off for the year, when the taxpayer is free to keep the money he or she earns.

In 1994, Tax Freedom Day fell on May 5, tying 1981 with the latest Tax Freedom Day in U.S. history. In 1989, Tax Freedom Day fell on May 4. In 1964, after President Kennedy's tax cuts, Tax Freedom Day fell on April 13, nearly three weeks earlier.

TAX CUTS AND THE BIGGER PICTURE

There are many economic problems facing the country that demand our attention. Many of these problems were discussed in great detail and clarity by the President's Entitlement Commission. Among these problems, I would emphasize that:

- Our rate of national saving is very low and constitutes a serious threat to long-term prosperity;

- Our rate of private investment is probably insufficient to create sustained growth in high-wage jobs; and

- The federal deficit, while less of a problem today than just a few years ago, is projected to grow rapidly in the coming years unless corrective action is taken.

Another problem related to all of the above is the anemic growth in productivity. Whether your main concern is wage growth, job growth, international competitiveness, or the economic futures we leave to our children, it all boils down to increasing productivity.

Productivity, measured as output per hour of all persons in the nonfarm business sector, grew at about 2.4% between 1959 and 1969, slowed to 1.3% from 1969 to 1979, and slowed further to 1.2% between 1979 and 1993 (and even this may be artificially high due to the surge in productivity experienced during the recent recession). This general pattern has been repeated in most of the major industrialized nations.

Tax policy is one of many influences on our economy. Even a perfect tax policy on economic efficiency grounds will not guarantee prosperity if we make enough other mistakes. Nevertheless, tax policy can contribute to higher productivity growth in many ways, most of which can be summed up by simply getting out of the way. Tax policy can best contribute to higher productivity by getting the tax disincentives out of saving, investing, business formation, and risk taking.

A TAX CUT CHECKLIST

In many ways, the current prospect of cutting taxes is extraordinary. And it would be an extraordinary shame if the exercise were completed in such a way that it ignored some of our long-term economic problems. Thus, I would like to offer a simple 5-point checklist for choosing among the tax cuts under consideration.

1) The tax cut package should not increase the budget deficit.

2) Tax cuts for individuals should not be paid for by raising taxes on businesses.

3) Tax cuts for low- and middle-income taxpayers, however defined, should not be paid for by raising taxes on the rest of our citizens.

4) Whatever tax cuts are enacted, they should not make the tax system more complicated than it already is.

[Complicating changes in tax law impose their own costs on the taxpayer in time and energy spent trying to comply with the changes. It would be a great shame if the taxpayer's tax burden were reduced while his compliance burden were increased.]

5) Whatever tax cuts are enacted, even though passed relatively quickly, should not be chosen to meet short-term political goals but should instead be designed to address the needs of a long-term policy consistent with sustained economic growth. The current spate of proposed cuts should be developed as a near-term down-payment on a long-term program of fundamental tax reform.

TAXES, CHOICES, AND PROSPERITY

Everyday, each of us faces choices: should we go out to dinner or eat in tonight; should we buy a fancy new car or go with something more moderately priced; should we do our own taxes or pay somebody to do them for us; should we take a vacation or save the money for a rainy day; should we work this weekend or play golf; should we work at all or should we stay home and raise a family?

Each of these choices is made based on a variety of factors, one of which is almost always the relative costs of the alternatives. If I dine at home, then I have to buy the groceries, cook the food, and clean up. If I go out, then somebody else will do the work, but it might cost twice as much. If I buy the moderately priced car, then I may have enough left over for a nice vacation this year. Each set of opportunities carries a price, and so we speak of the price of one choice relative to the price of the choices foregone.

Virtually every tax affects some group of relative prices. Some of these effects are relatively easy to predict. For example, a new 5 cent per gallon tax on gasoline is probably going to raise the price of gasoline by about 5 cents relative to the price of most everything else. Other effects are much harder to predict. For example, it is very difficult to know who actually pays the corporate income tax in the sense of suffering a reduction in after-tax income.

The individual income tax is often not too difficult to diagnose. We know, for example, that as the marginal tax rate on earning income rises, individuals will choose to work less where possible because the relative price of labor to leisure has gone up. We also know that income tax is imposed on income from saving, thereby creating a disincentive to save.

The Power of Little Changes

It is sometimes hard to understand intuitively how small changes can affect economic incentives. After all, if you need to buy gas to drive to work, you are probably going to buy the gas whether it costs $1 or $2, so you will almost certainly buy it at $1.05.

Over time, however, changing relative prices can have profound effects on behavior. For example, at $2 a gallon for gasoline you may be inclined to buy a more fuel-efficient car next time, or you may move closer to work, join a car pool, or take mass transit.

Most of the time most people willing to buy a product at one price will still buy it if it costs just a bit more. That does not mean, however, that small changes in price do not affect individual choices. Why else is the Sunday paper filled with advertisements and coupons offering a few cents off on this product or that? Why else do retailers advertise their sales? When you drove to work this morning, whether you were listening to Christian radio or Howard Stern, there's a good chance you heard the local automobile dealerships advertising the "biggest sale of the year" two weeks into 1995.

Advertising a sale works because there are always consumers who are wavering between choices and who will respond to a new price differential. To be sure, most consumers will not be swayed by a small change in price. But those consumers who are wavering between their choices, those consumers who are on the margin, will respond and may respond strongly.

What holds true for buying cars also holds true for the choice to save and invest income rather than to consume it, and for working more or working less. Marginal tax rates, that is, those rates that apply to the next dollar of income or the next dollar of expenditure, can have powerful effects on the choices individuals make.

The Tax Foundation performed an analysis of marginal tax rates in June, 1994, some of which is presented in the table below, which demonstrates the extraordinary bias in the tax code against saving. The table presents the total effective marginal tax rates on different types of income after accounting for the tax increases of 1993.

1994 Effective Marginal Income Tax Rates by Type of Income

Type of Income	Total	Federal	State
Wages	27.5%	22.8%	4.7%
Interest	34.5%	29.7%	4.8%
Business	38.2%	32.9%	5.3%
Dividends	42.1%	36.8%	5.3%

These figures indicate, for example, that an individual considering whether to invest an extra dollar in corporate equity must pay 42 cents in total tax for every $1.00 earned. When potential investors consider whether to spend a dollar on consumption or to invest it, it should come as no surprise that individuals so frequently choose consumption.

While all modern taxes distort individuals' decisions, not all tax cuts reduce these distortions equally. Some tax cuts can have a profound effect on how much individuals save, how much they invest, and how much they are willing to work. Others will have very little effect at all. It's all a question of rates: statutory tax rates, average tax rates, and marginal tax rates.

Consider a typical American family. The Census Bureau reports that the median income of a two-earner family in 1994 was $53,354. According to a Tax Foundation analysis done in November of last year, this family faced an average federal income tax rate of 10.4 percent and a marginal federal income tax rate of 28 percent.

Now consider two alternative tax plans, the first of which would increase the personal exemption for all taxpayers by $2,000; the second would allow taxpayers to contribute $2,000 to an Individual Retirement Account (IRA) and reduce their taxable income by $2,000.

The first plan would reduce the family's average tax rate on all income to 9.4 percent; it would not affect the family's marginal tax rate on either wage income or savings. Consequently, this plan would not reduce the tax disincentive to work since another dollar of labor income still faces a marginal tax rate of 28 percent. Nor would this plan reduce the tax disincentive to save since the tax reduction occurs whether the taxpayer saves or not.

Now consider the second plan whereby taxpayers are allowed to contribute $2,000 in pre-tax income to an IRA. Like the first plan, this plan does not reduce the marginal tax rate on labor. However, this plan does reduce the tax disincentive to save because the tax reduction is linked directly with the amount of saving that occurs through the IRA.

IRAs increase private saving because they reduce the tax burden on saved income, thus lowering the price of saving relative to consumption. That IRAs tend to increase private saving is certain; the amount of the increase, however, is certainly open to debate.

There was a time not long ago when tax policy discussions took place almost entirely in terms of economic incentives, marginal tax rates, and long-term goals. These concepts, which reached a height of popularity in the debate leading up to the 1986 Tax Reform Act, have since been overtaken by revenue estimates and tax fairness.

Whatever one's opinions about the 1986 Tax Reform Act, the motivations of the Congress and the President were right on target. Whatever tax cuts are passed in the coming few months would most benefit the nation if they adhere to those same motivations, if not necessarily the same types of results, such as reducing the disincentives to working, saving, and investing.

NEAR-TERM OBJECTIVES AND LONG-TERM REFORMS

One statement on which virtually everyone agrees is that the current federal income tax system is too complicated, too expensive to operate and comply with, and far too much of a burden on the economy. The question is, what should be done about it?

The Majority Leader, Congressman Dick Armey (R-TX), has a tax reform plan built around the concept of a flat tax which seemed to be picking up steam before the November election, and which must now be assumed to have been given a big boost by that election.

Senators Domenici (R-NM) and Nunn (D-GA) have their own detailed tax reform plan that is expected to be introduced in the next few weeks. These plans are sufficiently similar -- they both emphasize simplification and the elimination of the multiple taxation of saving -- and have drawn enough support from diverse quarters, that it may be safe to assume that they represent the starting point for the coming tax reform debate.

As the Committee considers various options for cutting taxes in the near term, it will save itself and the taxpayers unnecessary hardship if it keeps in mind the direction tax reform is likely to follow. If you believe that the Armey/Domenici-Nunn approach is the path we are likely to follow, or if you believe that lower marginal tax rates and a simpler income tax is where we should be heading, then some elements of the Contract with America are very likely to be consistent with future tax reform efforts. Capital gains relief, neutral cost recovery, and the improved IRA called the American Dream Savings Account are all likely to be consistent with future tax reform.

On the other hand, however well intentioned, it is less likely that the child tax credit and the adoption tax credit, if enacted in the tax cuts of today, will survive the tax reform of tomorrow because they complicate the tax code without offering any offsetting benefits in terms of marginal tax rate reduction.

TAX RELIEF AND DEFICIT REDUCTION

The federal budget deficit remains a very serious problem despite a series of large tax increases. Some have argued that we should take advantage of the current willingness of the Congress and the American people to cut federal spending and use those cuts to reduce the deficit. Others have argued that there should be a division of the spending cuts between tax relief and deficit reduction. Anyone concerned about the federal deficit should take heart in the current exercise, and not merely because of the general agreement that the bill should be paid for in full.

Most recent tax bills have raised taxes based on highly suspect revenue estimating procedures. (I do not mean at all to impugn the professionalism of the revenue estimators at either the Joint Tax Committee or the Treasury Department; but the fact is even the best navigator will get lost if the compass is faulty.) If the tax bill that emerges from this exercise includes tax increases on some to pay for the tax reductions on others, then it, too, will fail to achieve the expected revenues and we face the possibility of increasing the budget deficit.

Spending cuts, in contrast, are far easier for the Congress to guarantee because it is not a question of one group or another responding in predictable ways to tax increases; the Congress merely has to forego spending the money as enforced by lower spending limits. With tax increases, therefore, the economy must behave as predicted to achieve the expected revenues; with spending cuts, the Congress must merely act on its own decisions.

Just as tax increases generally raise less, (and sometimes much less), revenue than forecast by the estimators, tax cuts rarely cost the Treasury as much in tax revenues as the estimators expect. Of course, in each case the amount of error will depend on the nature of the tax reduction. Estimates of the revenues lost from increasing the personal exemption or establishing child tax credits are likely to be reasonably accurate because little economic activity will be affected.

In contrast, the Social Security earnings limit increase, the American Dream Savings Account, capital gains relief, the increase in the amount of capital purchases that a small business may expense, even the proposed estate tax relief, all may cost less than estimated because they will each stimulate economic activity, thereby increasing federal revenues from a variety of sources.

REVENUE ESTIMATES AND COLLECTIONS

The revenue estimating process is one of the most poorly understood and poorly reported aspects of the tax debate. Without going into an extended discussion of static versus dynamic revenue estimates, two examples should demonstrate why a tax bill using spending cuts to pay for tax cuts that improve economic incentives will actually reduce the budget deficit through the non-inflationary stimulative effects of the tax cuts.

The Capital Gains Exclusion

The capital gains exclusion in the Contract with America is similar to previous proposals that the Congress has considered. Four dominant revenue effects will follow from such a proposal: an exclusion effect, a realizations effect, a price effect, and a growth effect. Of these four, the current estimating procedures account for the exclusion and realization effects with great precision and detail, and ignore the price and growth effects altogether.

A capital gain arises when an asset is sold that has appreciated since its time of purchase, that is, when the capital gain is realized. Of the four effects, the exclusion effect is the easiest to understand and to measure. Quite simply, given a level of net capital gains realizations, a 50 percent exclusion would reduce by half the amount of realizations subject to tax.

In a given year, taxpayers own a certain body of assets which have appreciated in price. From this pool of appreciated assets they will sell a certain dollar amount on which will arise a certain dollar amount of taxable capital gains. For each taxpayer, the decision to sell an asset may be the product of many factors, one of which is the tax on capital gain that may be owed. Clearly, the higher the rate of tax the less disposed the taxpayer will be to sell a tax-bearing asset. The effect of a capital gain exclusion is to reduce the effective rate of tax, and thereby reduce the disincentive to sell the asset. Consequently, all else held equal, a capital gains exclusion will increase the rate of capital gains realizations.

Few issues in tax policy have been so thoroughly researched empirically as the change in capital gains realizations following a change in the effective tax rate. And, despite the differences in their estimates, the Treasury Department and the Joint Tax Committee actually use very similar estimates of taxpayer response so that the difference in their estimates is statistically meaningless, even though the difference in dollar terms may be quite large.

One effect that neither Treasury nor the Joint Tax Committee account for is the price effect of capital gains relief. An asset's price is determined by the discounted value of all after-tax proceeds from that asset. Clearly, for any asset inclined to increase in price, a lower capital gains tax will produce a higher asset price. Therefore, any reduction in the effective capital gains tax rate will surely produce a general increase in asset prices, thereby increasing the current pool of unrealized capital gains, thereby further increasing the dollar volume of capital gains realized in a given year and increasing the aggregate amount of capital gains tax paid.

Finally, capital gains relief is proposed because it is expected to reduce the tax disincentives to save and invest, ultimately producing stronger economic growth. While the degree to which a given capital gains proposal will have this beneficial effect is debatable, the existence of the effect itself is not. Nevertheless, the official estimates make no effort to include even the slightest growth effect in their calculations. Moreover, this effect would manifest itself not only in terms of higher subsequent capital gains tax receipts, but also as higher receipts from virtually every tax and fee imposed by the federal government.

Even if the combination of the exclusion and realization effects reduces federal receipts as the official estimates predict, when we add in the combination of the price and growth effects, then a 50 percent exclusion of taxable gains will almost certainly produce higher federal receipts in both the short run and the long.

The Social Security Earnings Limit

The Social Security earnings limit applies to taxpayers under 70 years of age and reduces their Social Security benefits by one dollar for every three dollars they earn over a specific threshold. The earnings limit, therefore, is the economic equivalent of a 33 percent income tax surcharge on those affected. Any raising of the earnings limit threshold or the benefit loss ratio reduces the effective tax disincentive facing the elderly who wish to continue to earn labor income. Such a change would also, in the first instance, increase the federal outlays for Social Security benefits, thereby increasing the budget deficit.

Raising the earnings limit would have other, revenue increasing effects, as well, which are not included in the official estimates. For example, if an elderly individual chooses to work more following the increase in the earnings limit, he or she will be subject to payroll tax on the earnings. Thus, while the amount of benefits paid increases, so, too, does total payroll tax receipts.

Also, the General Fund of the Treasury would receive an increase in individual income tax receipts as the elderly would likely have larger amounts of income subject to income tax. In fact, the elderly are likely to pay more of a wide variety of federal levies if they choose to work longer following the raising of the earnings limit. In combination, each of these effects may not cause the increase of the Social Security earnings limit to reduce the budget deficit on net, but they certainly would reduce the amount of the deficit increase relative to the official estimates.

The congressional leadership has indicated that it will accept the methodologies of the past for purposes of scoring the Contract with America's proposals and that the bill or bills will not be permitted to increase the federal budget deficit on that basis. Since the Contract will be revenue neutral on a static basis, and since many of the tax cuts will cost the Treasury less than the official static estimates indicate, it therefore follows that the federal deficit will be lower than it otherwise would have been following the enactment of this bill.

CONCLUSION

The Congress has embarked on a program of change in the role of government. Less is now perceived to be better than more. And yet, as in most things, some means of achieving the desired results are better than others. The 5-point checklist presented earlier, and again below, may be taken as a guide to these policy decisions:

- Deficit neutrality;
- Individual tax cuts without business tax increases;
- Eschewing the tax shuffle of cutting some individuals' taxes while raising other individuals' taxes;
- Avoiding complicating tax changes; and,
- Reducing the micromanagment of the economy through the tax code.

If the Congress follows this checklist, then whatever bill is sent to the President is very likely to achieve results every American can support.

Finally, if we really believe that the American people spoke in the past election in favor of less government and more freedom, then perhaps Tax Freedom Day provides a good measure of what is or should be accomplished. Tax Freedom Day in 1994 was May 5, tying 1981 with the latest day ever. Perhaps it would be useful if the Congress were to decide how many additional days of tax freedom the American people really want. Was the recent election a call for one more day of tax freedom? Two? A week?

And then, having decided how much additional tax freedom the American taxpayer wants, that then should be the guide to how far taxes and spending need to be cut.

Mr. BUNNING. Ms. Lav.

STATEMENT OF IRIS LAV, ASSOCIATE DIRECTOR, CENTER ON BUDGET AND POLICY PRIORITIES

Ms. LAV. Mr. Chairman, thank you for inviting me to testify this afternoon on the Contract. I am Iris Lav, the associate director of the Center on Budget and Policy Priorities, which is a nonpartisan organization that studies government spending and policies that affect low- and moderate-income Americans.

My analysis today highlights four key problems in the Contract. Three problems relate to the tax proposals. The tax proposals threaten to increase the long-term deficit. The distribution of the tax benefits are strongly skewed to upper-income families. Significant new opportunities for tax shelters would be opened. In addition, the proposals to block grant means tested entitlements create difficult new problems for States.

Starting with the tax cuts, we are particularly troubled by the long-term impact of the proposals on the Nation's deficit. By long term, I mean beyond the 5-year budget window that is traditional and even beyond 2002 when a proposed constitutional amendment for a balanced budget would take effect.

The Center's executive director recently served with Chairman Archer and others on the Bipartisan Entitlement Commission. The Commission did not reach consensus on solutions, but its diagnosis of the looming fiscal crisis is stunning and cannot be ignored. Even in the absence of tax cuts, the deficit would reach nearly 6 percent of GDP by 2010 and nearly 19 percent of GDP by 2030. The tax cut provisions would exacerbate this problem. The Contract tax cuts reach a cost of nearly $120 billion a year by 2005 and keep growing after that.

This is the same time when the continued growth in health care costs and the aging of the population together will begin to substantially increase the Federal budget deficit. Once put in place, these large and growing revenue losses will become a formidable obstacle to achieving the long-term deficit control that will be critical to the economic health of this country.

Four of the Contract's proposed tax cuts are particularly troubling. They account for most of the growth in cost. These four, the new IRAs, capital gains, depreciation, and Social Security benefits taxation grow in cost from $53 billion in their first 5 years to $317 billion dollars in the second 5 years, a six-fold increase.

Yesterday, Treasury testified on the distribution of the benefits of the tax cut. I would like to add two additional perspectives. First, the four provisions I highlighted as increasing rapidly in cost primarily benefit higher income taxpayers. However, the middle-class child credit doesn't grow much. The cost is steady. The child care credit therefore is half the total cost of the tax cuts in the first 5 years, but less than one-third in the second 5 years.

Second, the depreciation provisions will increase the aftertax profits of the very largest corporations in this country. Less than one-half of 1 percent of corporations with net assets exceeding $100 million are likely to take three-quarters of the increased deduction. This dimension of the potential for new tax shelters: For example, the depreciation and capital gains proposals adjust depreciation allowances and the cost basis of assets respectively for inflation, but investors will be able to continue to deduct the full cost of interest on borrowing to purchase the assets. This will result in negative tax rates on the profits from some investments because the deductions will exceed the income subject to taxation. The excess deductions will be available to shelter other types of profits. Eventually there will be almost no tax on capital.

In considering these tax proposals, I would urge you to focus not just on the cost in the first 5 years, but on their total cost when their full effect would be felt in the second 5 years and beyond. I would urge you to be fiscally conservative with respect to these tax proposals and not to open up large revenue losses and tax-sheltering opportunities. The Nation will not be able to afford a large and growing revenue drain as it copes with the demographic and budget imperatives of the next 30 years.

A quick comment on the Personal Responsibility Act. We see a number of problems as programs such as food stamps and AFDC lose entitlement status and are converted to block grants. Block grants do not respond when the country falls into recession. That is important because after unemployment compensation, the current food stamp program is the second most important automatic stabilizer that the government has. In the last recession, the food stamp rolls rose by 5 million people. AFDC caseloads also increased. Under block grants, no additional Federal funds would be forthcoming to meet needs.

In addition, it is probably impossible to design a formula that fairly allocates funds among States and that responds to changing economic circumstances in each State. We believe welfare systems can be reformed, States can be given greater flexibility, and if you desire, spending could be cut without eliminating the entitlement status of these programs. The problems block grants entail could be avoided.

Thank you.

[The prepared statement and attachment follow:]

TESTIMONY OF IRIS LAV
Associate Director, Center on Budget and Policy Priorities
before the
House Ways and Means Committee
January 11, 1995

Mr. Chairman and members of the Committee, thank you for inviting me to testify this afternoon on the Contract with America. I am Iris Lav, Associate Director of the Center on Budget and Policy Priorities. The Center is a non-partisan, not-for-profit organization that studies government spending and the programs and public policy issues that have an impact on moderate- and low-income Americans. Our work is supported by foundations, individual contributors, and publications sales.

I will focus my remarks today primarily on the revenue proposals in the Contract with America, although I also want to raise a few issues before I close about the Contract proposals to transform major low-income entitlement programs into block grants.

Our analysis of the Contract highlights four key problems:

- the tax proposals threaten to increase the long-term deficit,
- the distribution of the tax cut benefits is strongly skewed to upper-income families,
- significant new opportunities for tax shelters are created, and
- the proposals to block grant means-tested entitlements create difficult, new problems for states.

Turning to the tax cuts, we are particularly troubled by the long-term impact of those proposals on the nation's deficit. And by long-term I mean beyond the traditional five year budget window, and even beyond the seven year period to 2002, when the Contract's proposed constitutional amendment requiring a balanced budget would take effect.

The executive director of my organization, Robert Greenstein, recently served with Chairman Archer and others on the Bi-partisan Commission on Entitlement and Tax Reform. And while the Commission was not able to come to consensus on solutions, its diagnosis of the looming fiscal crisis is stunning and cannot be ignored. In the absence of any tax cuts, the deficit would reach nearly 6 percent of GDP by 2010, nearly 12 percent of GDP by 2020, and nearly 19 percent of GDP by 2030.

As the tax cut provisions are designed, the revenue loss grows rapidly in the out-years. Four provisions in the Contract — the new IRAs, the reduction in capital gains taxation, the greatly increased depreciation allowance, and the reduction of social security benefits taxation — are particularly troubling. These four provisions were designed to have small revenue losses — or even to raise revenues — within the first five years after enactment. But the revenue losses associated with these provisions increase dramatically outside the five-year budget period.

These tax cuts would continue to drain increasing amounts of revenues in the years after the turn of the century. This is the same time when continued growth in health care costs and the aging of the population are projected to substantially increase the federal budget deficit. Those deficit increases already are noticeable in the new CBO baseline released last week. But that is just the beginning of the problem.

The Contract tax cuts reach a cost of nearly $120 billion a year by 2005 — and keep on growing after that. Once put in place, these large and growing revenue losses will become a formidable obstacle to achieving the long-term deficit control that inevitably will be critical to the economic health of this country.

I should note that the Contract authors did not pioneer the design of tax cuts whose true fiscal impacts do not emerge until after the first five years passes. Such designs have a bipartisan history ever since the 1990 budget reforms required the cost of tax cuts to be offset within the first five years. Indeed, the tax cut recently proposed by President Clinton also has backloaded revenue losses, albeit on a much smaller scale. (See graph attached.)

As I mentioned, four of the Contract's proposed tax cuts account for most of the growth in cost. These four — IRAs, capital gains, depreciation, and social security benefits taxation — grow in cost from $53 billion in their first five years to $317 billion in the second five years according to Treasury's preliminary estimates. That is a six-fold increase in cost.

I will not take the time here to describe the design features that cause these tax cuts to grow dramatically over time. I have attached to my testimony a summary report that briefly describes these issues, and we have a more detailed report available for anyone who would like it.

I would, however, like to make a couple of points about the distribution of the benefits of these tax cuts, and about the strong potential they open up for creating new types of tax shelters.

I know you heard yesterday the data from the Treasury Department on the distribution of the benefits of the tax cut package. About half of the benefits would go to the ten percent of families with incomes exceeding $100,000 and nearly 30 percent of the benefits under the Contract's tax plan go to the two percent of families with incomes over $200,000. I'd like to add two additional perspectives to that.

First, the same four provisions that increase rapidly in cost also are the four major provisions in the Contract that benefit higher-income taxpayers. However, the tax credit for children — the major provision in the Contract that would benefit middle-class households — would remain relatively constant in cost over time. As the cost of the other tax cuts grow, the tax credit for children declines from over half of the total cost of the tax cuts in the first five years to less than one-third of the total cost of the tax package in the second five years.

Second, while the Treasury income distribution attributes the cost of corporate tax cuts to the owners of capital (who ultimately benefit from such cuts), it also is useful to look at which corporations are likely to benefit from the extremely costly depreciation provision in the form of increased after-tax profits. The benefits are likely to be distributed similarly to depreciation deductions under current law. And under the current law, the vast majority of depreciation deductions are taken by very large corporations. Approximately three-quarters of depreciation deductions are taken by the less than one-half of one percent of corporations with net assets exceeding $100 million. This is not a proposal that primarily benefits small- and medium-size businesses.

I cannot leave the subject of the Contract tax cuts without a mention of the potential for new tax shelters. Among other problems, the depreciation and capital gains proposals adjust depreciation and the cost basis of assets, respectively, for inflation. At the same time, investors will be able to continue to deduct the full cost of interest on borrowing to purchase assets. This will result in a negative rate of tax on the profits from some investments, because deductions will exceed the income subject to taxation. The excess deductions will be available to shelter other types of profits. (See example in box in attached report: *Tax Proposals in the Contract with America: Assessing the Long-Term Impact.*)

To summarize, in considering these tax proposals, I would urge you to focus not just on the costs in the first five years, but on their total cost when their full effect would be felt in the second five years and beyond. I would urge you to be fiscally conservative with respect to these tax proposals, and not to open up large revenue losses and tax sheltering opportunities. The nation will ill be able to afford a large and growing revenue drain as it copes with the demographic and budget imperatives of the next 30 years.

Finally, I would like to turn briefly to the proposals in the Contract's Personal Responsibility Act to block grant means-tested entitlement programs. I should note that Bob Greenstein will be testifying specifically on these proposals Friday before the Human Resources Subcommittee. I would just like to highlight a few problems we see if programs such as food stamps and AFDC lose their entitlement status and are converted to block grants.

First, a block grant would not respond to the increases in need that states face during recessions. Under the current financial structure for AFDC and food stamps, increased federal matching funds for AFDC — and an increase in 100 percent federally funded food stamp benefits — automatically flow into a state when recession hits and more families apply for aid. After unemployment compensation, the food stamp program is the second most important automatic stabilizer in the federal government's recession-fighting arsenal.

The recent recession provides an example. Between June 1990 and June 1992, as the national unemployment rate jumped from 5.1 percent to 7.7 percent, the number of people receiving food stamps rose by more than five million. But under a block grant, this provision of additional federal resources during recessions would end. A fixed amount would be provided to a state at the start of a year. If unemployment subsequently rose, the state would have to bear 100 percent of any additional cash and food assistance costs itself.

We believe this would pose serious problems for states. State revenues shrink during economic downturns, and many state programs are cut. Under a welfare block grant structure, states would be forced to choose between raising taxes (or cutting other programs more deeply in recessions) to address the mounting needs for low-income assistance or instituting across-the-board benefit cuts, making some categories of needy families and children ineligible for the rest of the year, or placing poor families that recently lost their jobs on waiting lists for aid.

If states responded by instituting waiting lists, two-parent families could be significantly affected. The subpopulation whose participation in AFDC rises most sharply in recessions is two-parent families.

It is probable that the loss of the automatic increase in federal funding during a recession would make recessions somewhat deeper and more protracted, weakening the national and state economies. The food stamp and AFDC programs function as what economists call "automatic stabilizers" — federal programs that moderate economic downturns by infusing more purchasing power into state and local economies when recession sets in. Under a block grant structure, the automatic stabilizer role played by these programs would be lost.

These problems are aggravated by another shortcoming of a block grant structure — it would badly misallocate funds among states. Any formula that could be used to allocate block grant funds among states would be based on data for a year in the past; the formula would not be able to reflect economic and demographic changes since that time. States whose economies had grown robustly since the year in which the data were collected would receive more funds than warranted, while states where economic conditions had deteriorated would receive too little.

Of particular concern is the fact that during a recession, the hardest-hit states would likely be subject to a "triple whammy." First, there would be insufficient federal funds nationally, since the federal funding level would not automatically rise with a recession. Second, the allocation formula would not recognize the depth of the downturn in states that had been hit hard. Finally, the states hit hardest by the recession would generally face large declines in state revenues and be among the states least able to provide state funds to respond to the additional need the downturn had created.

It should be noted that once these programs lose their entitlement status and are converted to block grants, there will be no turning back, despite whatever problems may ensue. Given the federal government's fiscal problems, it would be extremely unlikely to regain entitlement status for such programs for years to come.

There are strong calls from many quarters for flexibility in designing and operating low-income assistance programs; they merit careful attention. However, it is not necessary to go to block grants to give states flexibility. Nor is it necessary to go to block grants to reduce spending on such programs, if that is what Congress wants to do. Welfare systems can be reformed and states can be given flexibility without eliminating the entitlement status of these programs, thereby avoiding the problems block grants entail.

January 11, 1995

Attachment

TAX PROPOSALS IN THE *CONTRACT WITH AMERICA*: ASSESSING THE LONG-TERM IMPACT

By Iris Lav, Cindy Mann, and Pauline Abernathy

Overview

A number of federal tax and budget changes are proposed in the *Contract with America*, that Speaker Newt Gingrich has vowed to try to move through Congress early in 1995. Among other proposals, the Contract calls for changes that would reduce revenues by $205 billion over the next five years.[1]

The revenue losses from the Contract tax proposals would mushroom after the initial five-year period, totaling $725 billion over the next ten years. The growth in cost is largely attributable to proposals for a new type of Individual Retirement Account, reductions in the rate of taxation of capital gains income for individuals and corporations, a reduction in taxes for businesses that invest in buildings, machinery, and equipment, and a reduction in the extent to which Social Security income is taxable for higher-income taxpayers. All four of these provisions were designed to have minimal costs or even to raise revenues within the first five years, with revenue losses dramatically increasing outside the five-year budget period.

In addition, these four proposals all heavily benefit upper-income households and large corporations. The Contract includes a new tax credit for children that benefits middle class families, as well. But the tax credit for children accounts for less than one-third of total cost of the tax package in the second five years after enactment, when the costs of tax benefits for wealthy individuals and corporations explode.

A Treasury Department analysis of the distribution of the benefits of the total package shows that more than half of the benefits from the Contract's tax cuts go to the top ten percent of U.S. families, those with incomes over $100,000 a year. Nearly 30 percent of the benefits under the Contract's tax plan go to the two percent of families with incomes over $200,000.

There are a number of key issues with respect to the long-term impact of the tax proposals in the Contract with America and the interaction of these tax proposals with the Contract's call for a constitutional amendment requiring a federal balanced budget.

The revenue loss under the plan would rise dramatically after five years. The plan was presented as losing slightly over $190 billion in revenue over the next five years, itself a substantial amount. But a Treasury Department analysis finds that the Contract tax provisions would lose $205 billion in the first five years rising to $520 billion in the second five-year period after enactment — bringing the total revenue loss to $725 billion over the next ten years.

Most of the growth in revenue loss over time is attributable to four provisions. The IRA, capital gains, business depreciation, and social security provisions are designed so they lose smaller amounts or even *raise* revenue over the next five years — and then lose much larger amounts of revenue after the five-year budget period ends.

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[1] Revenue numbers are from the Treasury Department preliminary analysis of the Contract as introduced as legislation, January 10, 1995.

IRAs

The Contract would create a new, more generous type of Individual Retirement Account tax break — called an "American Dream Savings Account" — that would be available to taxpayers at all income levels. Upper-income taxpayers covered by private pension plans who lost eligibility for traditional IRA tax breaks in the Tax Reform Act of 1986 would be able to take advantage of this new tax benefit.

- According to Contract sponsors, the IRA proposal raises $5 billion over the next five years. Short-term revenue gains would come from incentives for holders of current-law IRAs to pay taxes on those holdings now, rather than at retirement, and roll over the funds to the new, more generous and more flexible IRAs.

- After the rollover window expires, however, the revenue losses mount. In the second five years, this proposal would lose nearly $18 billion, according to the Treasury Department. Past analyses of similar proposals indicate that losses would continue to mount even after the second five-year period and could eventually be as high as $10 billion per year.

Capital Gains

The Contract would reduce the taxation of capital gains income — profits from the sales of assets such as stocks, bonds, and buildings — in two ways. Taxpayers could exclude from taxation the portion of profits that is attributable to inflation. In addition, half of the inflation-adjusted profits would be excluded from taxation.

- The Contract puts the cost of the capital gains proposal at $56 billion over its first five years. In the years immediately after implementation, revenues are assumed to be boosted by an increase in asset sales as investors rush to take advantage of the new provisions.

- Over time, however, asset sales level off and the cost of inflation indexing increases. The Joint Committee on Taxation has estimated that the cost of such a provision in the second five-year period after enactment would exceed $160 billion; the Treasury Department places the cost in the second five years at $122 billion.

Depreciation

The Contract also proposes some complex changes in depreciation allowances. Depreciation is the way that businesses account for the use of capital investments such as buildings, machinery, and equipment in the production of business income. Since these items typically are used for a number of years, businesses deduct a portion of their cost from taxable income each year over a specified period of years. Under current law, total depreciation deductions over the life of the asset are limited to the original value of the asset. Under the Contract proposal — the "Neutral Cost Recovery System" — businesses could deduct amounts over the useful life of an investment that exceed the original value of the asset.

For example, a business purchasing a piece of equipment for $100,000 could deduct $135,000 over the 10-year life of the equipment, rather than the $100,000 permitted under current law.[2] These changes are extremely costly.

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[2] The higher depreciation over the life of an asset is the result of indexing the value of the depreciation deduction for inflation and, for assets with a depreciable life of less than 10 years, allowing an (continued...)

- The Contract lists the depreciation proposal as *raising* $20 billion over the first five years and Tresury estimates it raises $18 billion in that period. The proposal is turned into a revenue gainer for this initial five-year period by decreasing, in the first few years, depreciation allowances for equipment that turns over frequently, such as computers and vehicles.

- Depreciation for longer-lived assets is made much more generous, however, and the long-term costs of this proposal are large. The Treasury estimates the depreciation provision as proposed last September would lose more than $180 billion in the second five years. The provision was modified when the Contract was introduced as legislation in January, but the revenue loss from the revised depreciation provision is still $139 billion in the second five years.

Social Security

Another provision in the Contract would repeal the 1993 change in taxation of Social Security benefits of higher-income beneficiaries. In 1993, Congress increased the percentage of Social Security benefits subject to taxation from 50 percent to 85 percent for single taxpayers with annual incomes above $34,000 and for married couples with annual incomes above $44,000.

- The provision lowering the proportion of Social Security benefits subject to taxation for higher-income beneficiaries would be phased in so that its full revenue-losing effects are delayed. The Treasury analysis shows its losses would rise from $15 billion in the first five years to $33.5 billion in the second five years.

Just these four proposals in the Contract, which have a net cost of approximately $53 billion in their first five years, would have a combined cost in the second five-year period of about $317 billion — more than six times the initial cost. These four provisions are the major reason the cost of the Contract tax provisions grow so fast, from $205 billion in the first five years to $520 billion in the second five years.

The four provisions with escalating revenue losses primarily benefit upper-income taxpayers and large corporations. The changes in IRAs, capital gains taxation, and the taxation of Social Security income would primarily benefit those at higher income levels. The vast majority of the revenue loss from the change in depreciation would result from a tax reduction for the nation's largest corporations.

- Past analyses indicate about 95 percent of the benefits from the IRA proposal would accrue to the top fifth of the population.

- According to analysis by the Joint Tax Committee, almost half of the benefits from the capital gains provisions would go to the wealthiest one percent of the population.

- The reduction in the proportion of Social Security benefits that are subject to taxation would give a tax break to the top 13 percent of beneficiaries.

- Under the current law, the vast majority of depreciation deductions are taken by very large corporations. Approximately three-quarters of depreciation deductions are taken by the less than one-half of one percent

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[2] (...continued)
additional adjustment in excess of inflation. These calculations were made assuming a modest three percent rate of inflation. If inflation were higher, the depreciation over the life of the asset would be greater.

CAPITAL GAINS PROVISION IN *CONTRACT* COULD CREATE TAX SHELTERS

Under the capital gains proposal in the Contract with America, the taxation of capital gains income — profits from the sales of assets such as stocks, bonds, and buildings — is reduced in two ways. Taxpayers exclude from taxation the portion of profits that is attributable to inflation. In addition, half of the inflation-adjusted profits are excluded from taxation.

At the same time, large investors who borrow to make investments would still enjoy a tax deduction for the full amount of their interest on their borrowing. The borrowing costs (interest deduction) would not be adjusted for inflation.

As a result, many investors would be able to deduct from their taxes amounts that *exceeded* their profits. The excess deductions could become a tax shelter for other types of income.

Example:

An investor borrows $100,000 to be repaid over ten years at an 8 percent rate of interest. The borrower uses the funds to buy $100,000 worth of stock. Interest payments over the lifetime of the loan are $45,000 and are deducted from taxable income as incurred.[1]

Over the 10 years, the stock grows in value to $179,100. Under current law, $79,100 would be taxable as a capital gain. Under the Contract, only $22,350 of that $79,100 capital gain will be subject to taxation (assuming a modest three percent inflation rate).

Since the $45,000 of interest the investor deducted over the life of the loan far exceeds the $22,350 capital gain subject to tax, the investor has been able to use the remaining $22,650 to offset — or shelter — other income. The investor essentially has a negative rate of tax on the investment made with borrowed funds. Because of the unbalanced treatment of borrowing and investments, the investor not only would never pay any tax on the profit but could use the excess interest deductions to reduce taxes owed on other income.

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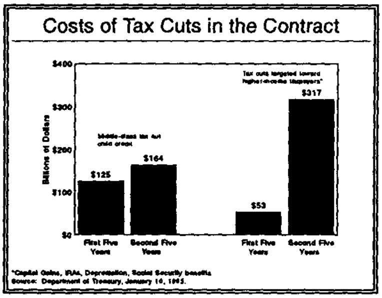
[1] Unlike consumer interest, which is not deductible, interest used to make investments may be deducted from taxable income so long as it does not exceed the amount of investment income reported in the year. If the investment in the example were the only investment the taxpayer had, then the interest on the loan would not be deductible each year because there would be no reported investment income until the stock was sold. By contrast, if the taxpayer had investment income each year from a large portfolio of investments, he or she likely would have sufficient investment income to deduct the yearly investment interest.

of corporations with net assets exceeding $100 million. The benefits of the increased depreciation deductions under the Contract proposal are likely to be similarly distributed.

The Contract's proposed tax cuts break the *quid pro quo* of the Tax Reform Act of 1986. The Tax Reform Act of 1986 sharply lowered income tax rates on wealthy individuals and corporations in return for scaling back the tax breaks provided for such things as capital gains, IRAs, and depreciation. Under the Contract, the tax rates faced by those in the top brackets would remain far below the rates such taxpayers encountered prior to the 1986 Act. But capital gains, IRAs, and depreciation tax breaks would not only be restored but would be made more generous than they were before 1986. The result would be windfalls for wealthy investors and large corporations.

The middle-class tax cut in the Contract dwindles in importance as upper-income tax cuts phase in. The cost of the major provision in the Contract that would benefit middle-class households, a tax credit for children, would remain relatively constant over time. It would cost approximately $124 billion over the first five years and modestly more than that in subsequent five-year periods. As the cost of the other tax cuts grow over time, the tax credit for children declines from over half of the total cost of the tax cuts in the first five years to less than one-third of the total cost of the tax cut package in the second five years.



The revenue proposals would jeopardize further progress on deficit reduction. The deficit has been halved as a share of the Gross Domestic Product since 1992, but the proposals in the Contract would put further progress in question. Over the next five years, large potential budget savings would have to be devoted to paying for tax cuts rather than continuing to make progress on deficit reduction. After five years, when the revenue losses would escalate, much larger cuts would be needed to keep the tax cuts from increasing the deficit.

When coupled with a requirement for a federal balanced budget, the tax cuts in the Contract virtually insure that programs on which the middle class relies — as well as programs that assist the poor — will have to be cut deeply. The fiscal strategy of the new Congressional majority calls for the establishment of a constitutional requirement for a balanced federal budget each year, starting in fiscal year 2002. The strategy also includes efforts to protect defense and Social Security from budget reductions and make it difficult to raise taxes in the future. To reach a balanced budget in 2002 under these conditions while offsetting the tax cuts proposed in the Contract would require all federal expenditures other than Social Security and defense (and the required interest on the national debt) to be cut nearly 30 percent compared to spending projected under current law for fiscal year 2002. In the years after 2002, the required reductions would grow still deeper. This suggests that major benefit programs such as Medicare, Medicaid, and student loans could be subject to substantial reductions and that federal support to states and localities for services such as education and transportation would be sharply scaled back.

The cost of the cut in the taxation of Social Security payments could be borne by elderly and disabled Medicare beneficiaries. The Medicare hospital insurance trust fund is out of long-term balance. The Medicare actuaries project that without changes to reduce Medicare costs or increase the revenues flowing into the trust fund, the Medicare hospital insurance trust fund will be insolvent by 2001. Yet the Contract would lower the taxes that are now deposited in the Medicare trust fund. The Contract proposes to cut the taxes of higher-income Social Security beneficiaries through lowering the proportion of their Social Security benefits that are subject to taxation; the revenues lost as a result of this proposal are now deposited into the Medicare trust fund. By withdrawing these revenues from the trust fund, the Contract would push Medicare further out of balance and require larger Medicare reductions or tax increases to avert insolvency.

High-income households would be the only clear winners under the Contract tax cuts. Several of the major revenue proposals — including the changes in IRAs, capital gains taxation, and the taxation of Social Security income — would primarily benefit those at higher income levels. Overall, the Treasury Department analysis found that about one-half of the tax cuts proposed in the Contract with America would go to the ten percent of families with incomes over $100,000. Nearly 30 percent of the benefits under the plan go to the two percent of families with incomes over $200,000.

Middle-income families would benefit significantly from the $500 per child tax credit, but whether middle-income families are better off in the long-run would depend on how the costs of the various tax cuts are financed. This is especially true in years after the five-year budget period ends, when the costs of the tax cuts primarily benefitting upper-income households and corporations begin to mushroom. If financing the tax cuts required sharp cuts in programs from which middle-income families derive substantial benefits or shifted costs to states and localities that had to raise taxes to accommodate those costs, significant numbers of middle-income families might find their disposable incomes reduced as a result of the offsetting actions.

Low-income households are the clear losers. They would gain little from the tax proposals. And the Contract's authors shied away from endorsing specific budget cuts before the election in most areas except one — programs targeted on the poor. Virtually all of the budget savings proposed in the Contract consist of reductions in basic food, cash, housing, medical, child care and other benefits for poor families and individuals. Low-income households would likely also be affected by other cuts that would ultimately have to be made.

Mr. BUNNING. Thank you very much.

Mr. Gibbons.

Mr. GIBBONS. I am worried about the timing of all the things that we are considering here. We have some very complex tax legislation before us and the only reason it is before us is because it is in the so-called Contract With America.

It seems to me that really the complexity of it and the size of it, $725 billion revenue loss over 10 years and growing very rapidly after that, should require Congress not to give it just the kind of cursory examination that we are doing here, but deliberate a long time about it.

What worries me further is that, as I look at the economy, we have got an economy that is heating up at a very rapid rate. The Federal Reserve is concerned about it and they have increased interest rates rather substantially in the last year, and I am worried that perhaps they are, if they watch us, they may increase interest rates even at an accelerated pace because we are at full de facto employment. We are at full capacity in our industrial production, and we have a huge budget deficit as well—and that is the perfect formula for another bout of inflation, and to talk about substantial tax cuts before we face the reality of inflation seems to me to be almost foolhardy.

I am not taking any position against any of the tax cuts per se, but worrying about inflation—am I on the right track? Should we really be talking about these drastic tax changes in the first 100 days or should we keep our eye on inflation?

Ms. LAV. I think that inflation is an important thing to keep an eye on, I think, because the economy is quite healthy now. The deficit has been cut in half as a percent of GDP in the last 3 years, and I think this is the time when we have to worry.

The new CBO forecast shows in 2002 and 2003 and 2004 an upturn in the cost of particularly health care programs that are focused on the elderly, Medicare, and Medicaid, which has a substantial nursing home care for the elderly, the problem of cost increase, and the aging population together with health care costs are our major problems.

So we should take advantage of the healthy economy now and continue to pull down the deficit and worry about those long-term problems rather than enact tax cuts that will make the long-term problem worse.

Mr. BECKNER. I would respond by saying that for sustained long-term economic growth, I think the tax cuts would be very important. The American taxpayer is overburdened. The tax burden is at a historical high, as Dr. Foster pointed out, and the economy is doing well today, but what about 1 year from now? What about 2 years from now.

Mr. GIBBONS. We are going to be in a rapid inflation is the way I read it.

Mr. BECKNER. My understanding of inflation is it has a lot more to do with what the Federal Reserve is doing with the money supply than it does with tax and spending policy. I feel that over the long term reducing the rate of taxation and rate of government expenditures will have a long-term positive effect on economic growth and will not have an impact on inflation one way or the other.

Mr. GIBBONS. Do you think Dr. Greenspan would agree with that?

Mr. BECKNER. I don't know.

Mr. GIBBONS. I can tell you I don't think he would. He has been there at that table a number of times and I believe he has cautioned against actions such as we are about to take.

Mr. KEATING. Certainly you can make his job more difficult by increasing the deficit. It certainly increases the temptation to monetize it. I would agree that inflation is very important. It is very important for many reasons, one of which is you can't have a free market economy if people can't know or have good reason to believe what the value of the money will be 5 or 10 years down the road. You can't make sound investment decisions.

Inflation also plays havoc with the Tax Code. We heard earlier how savings and investment, depreciation schedules, capital gains and the like all have very large distortions caused by inflation. Inflation is also a form of hidden tax on people who are retired who are on fixed incomes.

Many corporate pension plans pay out a fixed amount, and are not indexed for inflation. Inflation is a tax on people who are least able to pay. So I think it is very important to keep your eye on inflation. That is one reason why passage in this Congress of a balanced budget amendment to the Constitution and ratification by the States would really hold Congress' feet to the fire, and help keep the budget under control. Spending should not exceed revenues. This amendment would be an important complement to any policy changes made by this Congress.

Mr. FOSTER. Yes, sir, as usual, you have put your finger on the serious problem. If we go through the tax cutting exercise and violate point one on our checklist, that it should be done in a neutral manner accepting the scoring methodologies that we are currently employing, then as long as it is done in a deficit-neutral manner then we will be all right. The consequence of cutting taxes and spending simultaneously by like amounts is to free resources up to the private sector that are currently being used by the public sector.

Furthermore, again, not all tax cuts are created equal. If we enact tax cuts which expand the ability of the economy to produce, which increases the amount of private saving available for investment, increases the amount of investment and capital available to the labor force, increases the labor participation rates so that more people are inclined to enter the labor force, you then have a series of tax cuts which can expand the ability of the economy to grow without having an inflationary consequence. In fact, you will have a deflationary consequence because, by having tax cuts and spending cuts simultaneously in like amounts, you have increased the resource base, and the tax cut means that the economy employs those most efficiently. I would argue that that is a deflationary program.

Ms. LAV. I think that we have to be careful of the context here. We are not just talking about tax cuts. We are talking about a balanced budget amendment. If you enact these tax cuts and a balanced budget amendment by the year 2002, you have to cut nearly 30 percent of all spending other than defense and Social Security, assuming that those are off the table. That means that lots of costs are going to be pushed onto State and local governments. They represent about a third of what is left when you take Social Security and defense off the table. They cannot accommodate those costs unless they raise their own taxes, so that probably will push your tax. Since those State and local taxes fall more on moderate- and low-income people, that will push the Tax Freedom Day forward and not backward.

Also it is impossible to cut that much out of the Federal budget without imposing significant—Medicare is such a large part of it, there is likely to be significant cost shifting and that will cut into people's incomes. So I think you have to look at total effects and not just say that yes, you might be able to pay for the tax cuts, but then how are you going to pay for a balanced budget, and how are you going to put a downpayment on these demographic problems that are coming.

Mr. GIBBONS. Thank you.

Mr. BUNNING. Mr. Hancock.

Mr. HANCOCK. No questions.

Mr. BUNNING. Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman. Let me ask all the panelists whether or not your group is not-for-profit and what is the major funding source of your organization?

Mr. KEATING. Our group is a nonprofit, incorporated under 501(c)(4) of the Internal Revenue Code. Our funding sources are from our 250,000 members. Our average donation is $20.

Mr. KLECZKA. Do you also have corporate sponsors?

Mr. KEATING. We have corporate sponsors, but unfortunately very few.

Mr. BECKNER. Our foundation is supported by our individual members, by foundation support, and by the business community.

Ms. LAV. The Center on Budget and Policy Priorities is a 501(c)(3) nonprofit organization supported over 90 percent by foundation grants with small amounts from our publication sales and individual contributors.

Mr. FOSTER. The Tax Foundation is 501(c)(3). We are a nonprofit organization and one stridently nonpartisan, as I think the ranking member could attest. Our support comes from foundations, corporations, and individuals.

Mr. KLECZKA. I just wanted to be nosey, but it also gives me a background as to your views. Ms. Lav, in your testimony you indicate that if we go through with some of the changes that have been suggested, that we could possibly be setting up a tax shelter.

I wish you could brief the committee in more detail on that. I do think when we talk about the neutral cost recovery system, there is definitely the potential there for tax shelters. I would be interested to hear your views on capital gains also.

Ms. LAV. The problem with indexing capital gains, and I should say even without indexing, just the exclusion would bring us to the lowest rate of capital gains taxation since 1954, and indexing would be on top of that.

One of the problems with indexes for inflation is that the rest of the tax system isn't indexed. The brackets are, but wealthy investors typically borrow to make investments. Lots of people make investments with borrowed funds; not the small investors, but people who make a business of investing.

When you have investment interest, interest for investment purposes, that is fully deductible as an expense from your taxes. It is not a part of the interest that exceeds the rate of inflation; it is the whole thing. So if an investor borrows $100,000 to be repaid over 10 years at an 8 percent rate of interest and uses the $100,000 to buy an asset, the interest payments over the lifetime are $45,000, and assuming there is enough other investment income, they can be deducted from taxable income as they are incurred. After 10 years, the asset grows in value to $179,000. The $179,000 would be taxable under current law as a capital gain, but under the Contract, only $22,000 would be taxable, approximately.

So $45,000 of investment interest would already have been deducted. There is only $22,000 of capital gains subject to tax, so there is another $22,000 to shelter other income of deductions. Essentially you are throwing off more deductions by borrowing to invest than is the amount of your profit that is going to be subject to tax. In this way, eventually probably, coupled with other tax-sheltering opportunities, for example, matching losses that are created by the fact that you are indexing with other gains plus the fact that you have additional interest deductions, you essentially would get around to pretty much eliminating tax.

Mr. KLECZKA. Mr. Keating was shaking his head.

Mr. KEATING. I wanted to make one thing clear. The rules for deducting investment interest include a provision that you cannot deduct investment interest unless you have some investment income, so it is not completely deductible under current law.

There may well be some sheltering opportunities. The way to shut them down is not by refusing to index capital gains, but to reduce the deductibility of investment interest so you are not deducting more investment interest than you are getting in investment income total.

Ms. LAV. That is one of the sheltering. Actually you can carry forward the investment interest with a large investment.

Mr. KLECZKA. Thank you, Mr. Chairman.

Mr. BUNNING. Mr. Ramstad will inquire.

Mr. RAMSTAD. I appreciate the ideological diversity and the different perspectives that this panel brings today. It is refreshing to have such pluralism represented on a panel.

The leadoff witness explained to us a fact that I think everyone understands. The average family spends more on taxes per year than for food, clothing, and shelter combined; 30 years ago, put another way, the average middle-income family spent 3 percent of its income in taxes. Today, three decades later, that average family is spending 24 percent of its income in taxes.

Given those facts, which are just that, factual and not disputable, Ms. Lav, do you think that is what the American people want? You were very critical of our Contract's policy to reduce this burden of taxation and correspondingly, government spending.

Do you really think the American people want to continue spending more on taxes than they do on food, shelter, and clothing combined?

Ms. LAV. I think it is perfectly appropriate for Congress to look very carefully at all the spending the Federal Government does, and it is perfectly appropriate to try and reduce the burden and probably should reduce the burden by looking at whatever spending you think is not appropriate.

What I am saying is not appropriate is to sort of just cut the taxes and take the risk of increasing the long-term deficit when we know we have these problems coming that can not be avoided. What also is not appropriate is to shift the burden of who collects the taxes to State and local government because that won't do low- and moderate-income families much good.

I think that if there are ways to make government more efficient, if there is a decision that government should not perform some functions, that is an appropriate way to reduce taxes. But I think that you shouldn't put the cart before the horse, basically.

Mr. RAMSTAD. So as long as we make real spending cuts and not just play the shell game that has been played for too long, if we make real spending cuts and make them first to lay the foundation for the tax cuts, then you find that acceptable?

Ms. LAV. I would not agree with the particular tax cuts, particularly the capital gains and depreciation tax cuts in the Contract because I think those would ultimately increase the burden on low- and moderate-income households.

Mr. RAMSTAD. The other question concerns personal savings. I think everyone understands that we in America have the lowest personal rate of saving of any of the G–7 nations. A Harvard economist concluded recently that were we to put all our savings into plant and equipment, we could not sustain economic growth. That fact should be alarming to anyone who understands economics.

Yesterday the distinguished minority leader said he does not believe that tax policy can necessarily induce desired economic behavior. He really dismissed the idea of tax policy that would encourage personal savings. I would like to ask any of the witnesses, Mr. Beckner or Dr. Foster, Mr. Keating, since I asked Ms. Lav the last question, you three are fair game for this one, do you agree with the minority leader's assessment and, if not, what tax policies do you believe would promote personal savings?

Mr. KEATING. It is not so much that it encourages it. It probably never will as long as we have a tax system. The question is: How much are the disincentives on people that save for the future? If you look at the Tax Code, it is almost a miracle that anyone ever does save for the future. After taxes and inflation, it is very difficult, especially for the average person, to generate a positive rate of return over any period of time.

Now, entitlement programs provide more and more safety nets. Between the safety net on the one side and the tax penalties on the other side, it is a miracle that anyone saves, and the answer is, very few do.

As the Entitlement Commission showed, and as a recent report by our affiliated foundation showed, the benefits that are promised under current law—without adding any more entitlements—would require tax rates of anywhere from 57 to 69 percent by the year 2040.

The tax rates required to pay for these promised benefits are so large that even though the government projects incomes to increase over the next 45 years, our calculations show that after taxes people will likely only make $125 more on average than they do today. So we have to get those programs under control or we will be overwhelmed with either deficits, taxes, or both.

Mr. RAMSTAD. Thank you, Mr. Chairman and Mr. Keating.

Mr. BUNNING. Mr. Zimmer.

Mr. ZIMMER. Thank you. Ms. Lav, I would like to pursue your analysis of the, what you call the tax shelters that would be available under capital gains. As Mr. Keating pointed out, your gripe may be with the tax deduction that is available for interest payments.

Do you believe that the cost of interest is a legitimate business expense or not?

Ms. LAV. You know, I don't have a strong belief one way or another. There may be circumstances when it is. If one wanted to say that you couldn't deduct interest, that should be pretty much across the board so there wouldn't be distortions.

I think that the tax system shouldn't create distortions among different types of investments. I think they should be viewed on their own merit. I think either it is or it isn't deductible, but you wouldn't want to make it not deductible for capital gains, but definitely deductible for other kinds of business activities because that would cause a variety of distortions.

Mr. ZIMMER. Then since you are not prepared to attack the deductibility of interest, let's take the other half of your model, which is a proposal to allow the investor to disregard the portion of the capital gain that is attributable solely to inflation. Do you believe that it is fair to tax somebody on a nominal gain that doesn't reflect a real increase in value, but only reflects the decrease in the value of the dollar?

Ms. LAV. I think the way our whole tax system is set up, you could go to a tax system where every single thing was indexed and maybe you could find a way to tax people only on their real increase in wages and not the part of their wage increase that represented inflation.

We index the brackets, but that doesn't come to that—do the same thing. We don't have that system, and I think when you start taking pieces out of it and indexing it, you have a major problem. So yes, under the current system, it makes sense to tax people on their nominal gain. They are paying the taxes out of their nominal income.

Mr. ZIMMER. But if I paid $10,000 for an investment and I sold it for $20,000 and in the interim the cost of living has gone up 100 percent, where is my income? Where is my real income? Where have I increased the value of what I originally invested, and why should the Federal Government assume that I have made a killing of some sort? And why should your organization assume I am in some kind of tax shelter?

Ms. LAV. The shelter I referred to was the imbalance. You are sort of picking a piece out of the tax system and saying we tax all other kinds of nominal income, we are taxing nominal wage income, we are taxing nominal interest on saving——

Mr. ZIMMER. Every dollar that I get today is being taxed today at current rates, and on the current value of the dollar.

Ms. LAV. You make your profit today too.

Mr. ZIMMER. But I haven't made a profit. Explain to me why I have made a profit if the value of my investment——

Ms. LAV. Because today, the amount of money if you have invested $10,000 and you get $20,000, you have $20,000 in your hands today. That is value and you are going to get to keep a portion of it and a portion of it will be taxed away. It is not just the interest imbalance. There are other tax shelters that will be set up by that.

If somebody has a closely held business and makes profits, they are going to want to retain those profits and perhaps try and sell the business as a capital gain. There used to be collapsible corporations that people used when there was tax sheltering. So you set up all kinds of problems and they will give the lawyers and accountants a field day.

Mr. FOSTER. I am certainly no fan of tax shelters. That would fall under the heading of micromanaging the economy, which we don't favor, but if you take every opportunity in the Tax Code to wipe out a tax shelter, we might wind up living in huts.

The fact is the capital gains tax has an unfortunate effect on the economy. Capital gains indexing—this may be a very unique experience for me. I have never heard anyone attempt to make a solid argument against capital gains indexing.

The taxational, inflationary gains are grossly unfair.

The tax system is, in fact, tremendously indexed already. It is not just the brackets, it is personal exemptions and standard deductions. Our depreciation system, while complicated, is intended to come up with a simplified way of indexing depreciation for inflation. That is why we have a 200 or 150 percent declining balance system, as a shorthand, easy to work proxy for indexing for inflation.

Indexing matters because we have activities that occur in certain years that become taxable events in subsequent years. For most of what we do, wages and so forth, it is automatically indexed. You pay tax on wages the year that they are earned. So the entire system is tremendously indexed automatically, and where it is not, we have made provision to index it. Capital gains, other than the estate exemption, is one of the few areas where you don't either explicitly or implicitly already have indexing. Capital gains indexing would certainly remedy this.

It is possible that 10 years from now when we have passed these tax cuts, whichever ones we do pass, that they will all have been repealed again through two or three tax reforms in the intervening years. One thing we can be sure of is if you pass capital gains indexing now, there is a very high probability it will be law 10 years from now.

Mr. BUNNING. The gentleman's time has expired.

Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. I thank all of you for being here today. Your testimony is very helpful. I was intrigued, Dr. Foster, with reading over your statement. I am sorry I wasn't here to hear it. I read it and with regard to long-term tax reform and the system, I think, all of the criteria which you set forth, I would agree with probably most members of this committee.

You talked about the need for long-term tax reform to simplify the system to take some of the complexity out of it and to make economic decisionmaking real rather than tax decisionmaking. But you say that it is your feeling that a capital gains differential or indexing, would be consistent in your view with any long-term reform of the code.

Why do you say that? What is your basis for that statement?

Mr. FOSTER. I will break the two pieces out. Because in general we have been moving to an increasingly indexed tax system, and I think capital gains indexing is appropriate for many reasons.

Looking at the exclusion itself, if you examine the kinds of tax reform plans that are on the table, the major plans more fully thought through, and up until I think yesterday we had two that fit that description, the majority leader's flat tax plan and the Nunn-Domenici plan, both plans emphasize reducing or eliminating the multiple taxation of saving. That means, in both those plans, you are not taxing capital gains at all. So a 50-percent exclusion is halfway there to where we would be if we pass these tax reforms.

I am not arguing in favor of either or any reform plan, but that is just what they say. So anything that moves us in the direction of reducing the taxation on saving would then be consistent with those kinds of tax reform efforts, and I assume that those are the starting points, wherever we end up with the evolution of the tax reform debate.

Mr. PORTMAN. Would you include the IRA provisions in that?

Mr. FOSTER. Yes. The only caveat that I would add, and this is from personal experience shared by almost everyone who used the IRAs in the early eighties, if we have this sort of an expanded IRA system now and then 3 or 4 years from now we go through a tax reform that has a more vastly expanded IRA, you have to be careful that people who put their money into the IRA next year or this year because of what we do this year are not locked into that arrangement, that they can roll their investment into the new IRA.

For example, if you put money in an IRA in the early eighties, you are locked in. There isn't much you can do with that money. I hope if we do expand the IRA in the next year or two that we allow people who saved in the early eighties to roll that money into these new accounts and not keep these funds sequestered. That is a very inefficient way of investing. But no question, an expanded IRA, since it reduces the taxation of saving, moves us down the road consistent with that kind of tax reform.

Mr. PORTMAN. Let me ask a general question. How would you put deficit reduction along the spectrum in terms of increasing savings and investment in this country? Our savings rate is at the bottom of the G–7. I think that is generally a consensus among economists. Deficit reduction has been discussed today by Dr. Bosworth and others as a solution to that problem, and then we have the IRA solution, capital gains solution, and other incentives for saving.

Where would you put deficit reduction on that spectrum?

Mr. KEATING. I suppose if Ross Perot were here, he would say the deficits are the giant sucking sound against the savings rate.

The Federal Government's deficits and debts suck those savings to pay for these deficits, which will be spent largely on consumption items.

So you have to get toward a Federal balanced budget if you want to raise the national savings rate unless we see a huge, stunning turnaround in American cultural attitudes about saving. This is unlikely given the Tax Code, the safety net programs, and the entitlement programs that are making promises that can't be sustained into the next century.

Ms. LAV. I think we may sort of agree on this. I think that the savings rate has been remarkably the studies show unresponsive to tax incentives and that if we want to improve the savings rates, we have to improve the government dissavings by, in the long term, not necessarily every year and not necessarily today, but certainly address these issues as the population ages and as we have these deficits exploding in future years.

Mr. KEATING. I strongly disagree with the term tax incentives for savings. We don't have tax incentives for savings. It is a question of how much disincentive we have. And to the extent we reduce the disincentives, I think you can and will see, and did see with the IRAs, an increase in the savings rates.

I would not discount the effect of national advertising, because when people finally can save and make it worth saving, mutual funds, banks, and others will tell people about it because they want to manage the money. Advertising, I think, is greatly underappreciated as a potential effect on the national savings rate.

Ms. LAV. The question is whether it shifts savings from other forms and puts them into a tax advantaged or whether you increase the rate.

Mr. BUNNING. The gentleman's time has expired.

Mr. Cardin will inquire.

Mr. CARDIN. Thank you, Mr. Chairman, and thank you all for your testimony here today. I remember before 1986 when tax shelters were plentiful in this country, many of my friends and colleagues were investing in office buildings and condominiums with the guarantee that they couldn't lose any money because of the Tax Code and because of the writeoffs in the Tax Code.

Treasury testified yesterday before our committee that unless we make certain modifications in the proposal that has been made to us with the Contract With America that we will again see tax shelters, that because of the neutral cost recoveries and the other provisions in the bill, there will be circumstances where an investor because of the writeoffs and because of their tax brackets would be guaranteed to recover more money than they are laying out with no risk and still retain the asset.

My question to the panel is whether that concerns you, whether we should all be working together to make sure that we don't see tax shelters return to our Tax Code, where people's decisions are not based upon what is right economically, but are misled by the Tax Code itself in investing in a particular asset that we may not need.

As you know, we overbuilt offices and probably had more condominiums and rental pools at that time than were economically justified. I am interested as to whether this concerns you and whether Democrats and Republicans shouldn't be working together to make sure that we don't, through our desire to encourage investment, we don't start a new round of tax shelters.

Mr. BECKNER. I would say two things to that. One is, the tax reductions in the Contract With America serve to lower the tax burden. That to me is the most important policy goal here. The tax burden is too high. It hurts the quality of life of citizens. It lowers the economic growth rate.

That having been said, and both Mr. Keating and I talked about this, over the long term what we need to do is have a comprehensive tax reform where we dramatically simplify the Tax Code, where we have flat rate taxes——

Mr. CARDIN. Address though, the shelters. Remember, we knew we had shelters in the tax law and it took us many years and a long effort before we were able to repeal them. So if we create a new tax shelter, it is not going to be overnight before that comes out of the Tax Code.

Mr. KEATING. I would agree. If there are any problems with the Contract With America, I am sure the chief authors will be happy to take a look at them. I would say if there are sheltering problems, we certainly want to get those addressed.

I would like to point out one other problem with shelters which is not often talked about, and that is the way the IRS closed them down. A lot of people put their money into these shelters and they went with major investment firms. The fact is, a lot of these things collapsed, people found themselves losing money from them and then found the IRS would audit the shelters. There was no one left to defend them from the tax claims, the tax benefits were disallowed, and then the IRS picked off investors one at a time. Even if there were shelters in a new tax law, I bet you there are many investors that won't touch anything that is called tax shelter with a 10-foot pole because of what happened in the eighties and the way the IRS came after people.

Mr. CARDIN. What you are referring to happened after the 1986 tax law changes.

Mr. KEATING. The whole thing was a mess in terms of Tax Code enforcement.

Ms. LAV. Two quick points. Who paid for the tax shelters? A lot of the overbuilding led to the S&L crisis and the middle-income taxpayer certainly suffered from that.

Second, whenever there are differential rates and differential provisions in the Tax Code like indexing, like a lower rate on capital gains, you are going to have people manipulating to get their income to look like that kind of income. That happened prior to 1986.

If you want to—in 1986 the attempt was to say we are going to tax all income the same, capital gains at the same rate as everything else, and that is one of the ways we had losses. The shelters were shut down and now we are opening a gaping hole, the Contract opens a gaping hole to create these shelters and be creative again.

Mr. CARDIN. Thank you.

Mr. BUNNING. Mr. Christensen.

Mr. CHRISTENSEN. I thank the panel for their testimony. We heard from Mr. Bosworth about the need for an independent economic forecasting model, and one that was not giving us "funny numbers" with Treasury or CBO or the GAO or outside firms.

I am wondering what would be your recommendation and how would you go about setting up that kind of firm, because I thought we had that now, but I don't know that we do. No one seems to understand static versus dynamic scoring and everybody has a different plate.

How do you go about getting the right numbers? I am more interested in hearing the dynamic scoring which I believe is more accurate, but yet it seems like all the bureaucrats come in with static scoring, and I don't agree with it.

Mr. FOSTER. This is a truly serious problem. It is one of those things where, if we could make the change and make it correctly, it would have an extraordinarily long-term beneficial impact on policymaking. I probably would not agree with Dr. Bosworth just because I think if you were to create an independent panel of economists to come up with revenue estimates, you would never get any revenue estimates.

We have an opportunity now with Ken Kies of the Joint Tax Committee and with the Congressional Budget Office, to put in place a program, which is going to take awhile to do, to put in place a program of developing dynamic revenue estimates which eventually, whether they like it or not, Treasury is probably going to have to start doing as well, and keeping it in-house.

The CBO/Joint Tax Committee have resisted doing dynamic revenue estimates for a variety of reasons, as has Treasury. Most of those reasons I find having not much support, in fact. It can be done.

One thing we tend to ignore in this country is that the United Kingdom has been doing dynamic revenue estimates for quite some time, and yet the Treasury and Joint Tax have told us over the years that it can't be done. It tells us I guess that the British are smarter than we are because they have been doing this since the early eighties.

It can be done through CBO and Joint Tax, which is where I think it should be done because you really do want to have the staffpeople who are answerable to the Congress and these organizations are. They are going to have to embark on a program of learning how to do dynamic revenue estimates, not just for tax, but for spending proposals as well, and they probably ought to get to it pretty quickly.

Mr. CHRISTENSEN. Mr. Keating, yesterday we had the opportunity to hear from the Administrator of the Social Security Administration and your organization represents a lot of seniors also. She came to the conclusion that a moderate increase in the earnings cap for seniors was $200 a year. Over the next, I believe, 5 years she was going to be able to raise it $1,000. In the Contract With America we talk about raising that to $30,000.

Could you give me your opinion on the earnings cap and how that is being detrimental to seniors or whether you see it a different way?

Mr. KEATING. There are a lot of problems with the way it works. It essentially says if you have retired and are on Social Security and you make any extra money, you pay what is similar to the higher marginal tax rate.

What actually happens, as I understand it, is the benefits that are paid are actually higher if you were to get rid of the earnings test. The way it would actually be scored in the Federal budget is Federal spending would go up if you eliminate or make the earnings test more liberal.

So we advocate that if you are going to do it, and there are many logical policy reasons for doing so, that you also restrain the growth in Social Security benefits elsewhere so that overall you don't move up the date of bankruptcy for the Social Security system. If you do something with the earnings test, I believe it should be paid for with other changes in the same entitlement program which, as I understand, is what the House budget rules are now, and those are good ones.

Mr. CHRISTENSEN. Thank you.

Mr. BUNNING. Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman. Dr. Foster, getting back to this dynamic scoring thing that I have been talking about for a long time, you say the United Kingdom has been using a dynamic scoring in their budget projections, and, if so, could you get us some information—I would like to know a little bit more about it.

Mr. FOSTER. They have been doing it. A few years ago, in 1989, I had occasion to go over and visit with some of the fellows from the Ireland Revenue Service who actually were in the business of doing these sorts of estimates. It should be kept in mind that it is somewhat easier for them to do these because, in the parliamentary system, the Prime Minister comes up with a well-defined set of proposals, a single set and fairly narrow, and they run the estimates on this set of proposals, so it is not like the Joint Tax Committee eventually will be asked to do which is to provide estimates on an ongoing basis over the course of the year.

Mr. HANCOCK. I would just like to have some more information on it. I pointed out to the minority leader yesterday that business has been using it in this country, our own system requires dynamic scoring. In other words, when you invest money based on what is going to happen sometimes in 2 or 5 years or 10 years from now, you certainly do not use a static model. If you did use a so-called static model, then you would never make that investment in the first place because you would assume that everything is going to stay the same rather than having expanding markets.

I don't know whether you have ever done this, and I planned several times to call your organization and ask. You show on page 1 your Tax Freedom Day. That has always been an interesting date to me. Back in 1977, we held a big celebration on the square in Springfield, Mo., and got all the national news media calling it Tax Freedom Day, had a bunch of people from Branson come up and perform country music. On this Tax Freedom Day, you are showing Federal, State, and local taxes. Now, you are not including the increase in the debt of the Federal, State, and local governments. I am assuming that——

Mr. FOSTER. That is correct.

Mr. HANCOCK. Isn't the increase in the debt also the money being spent by the taxpayers, even though it isn't directly taxed from their income? I ran these figures not long ago using statistical abstracts with my calculator.

I would appreciate it if your organization would run some figures on this. I calculated that the cost of government in the United States right now is in excess of 70 percent of personal income. That is when you take the total amount of taxation that—you know, the money that the government actually taxes, add to that the increase in the debt of government at all levels, school boards, city councils, all the way, which is an increase in debt, that the total cost of government annually is in excess of 70 percent of personal income.

And I think that that is something that we need to talk about a little bit because there is no way that you can continue that type of spending if that is in fact what it is. I would appreciate it if your organization and maybe Dave Keating would look at it and the Citizens for a Sound Economy, because if that figure is correct, we are on a collision road to bankruptcy, and I think you will find that is not too far off. I would like somebody like you to verify that.

Mr. FOSTER. I would be glad to do so. Almost every year that we publish Tax Freedom Day, we receive a letter from Milton Friedman encouraging us to do just what you suggested.

Mr. HANCOCK. Maybe Mr. Friedman couldn't get it done, but maybe as a Member of the U.S. Congress we can.

Thank you.

Mr. BUNNING. Mr. Collins will inquire.

Mr. COLLINS. Just one question, Mr. Chairman. There has been a lot said about tax deductions for business or for individuals. Is it not true for anyone to take advantage or to enjoy a tax deduction, first, they must have an income. Second, they must spend portions of that income either in investment or in expenditure for capital outlay in the area of the tax-deductible item or the provisions allowing the deduction, which then further enhances the cash flow of the private sector. That, in turn, moves those funds through another set of hands, which then moves them to another set of hands. Each time those funds are transferred, the Federal, State, and local governments each get a portion of those funds. Is that not true?

Mr. FOSTER. I think that applies to just about every situation other than theft.

Mr. COLLINS. I think the Federal Government is stealing from its taxpayers and from its people.

Thank you.

Ms. LAV. I think that this is true, but we talked about taxing income. What this is moving, the Contract moves toward is having taxes only on wage income, because most forms of income from capital investment and profits would eventually be negligible once all of the Contract provisions are phased in. So I think that one has to think very carefully about whether one wants to just finance government by taxing primarily wage income.

Mr. COLLINS. Is it not further true though that businesses collect taxes from consumers through the goods and services it provides for sales; it is not really a tax on business. Isn't it true that businesses have no tax; they only collect through the products and services they render?

Ms. LAV. The taxes on business generally are considered to be distributed on the owners of capital, so the owners of capital would have no tax, that is true.

Mr. COLLINS. For a sale or service. I suppose from your perspective the dollars here in this town belong to the government and not to taxpayers?

Ms. LAV. No. I am saying that a certain amount of taxes have to be collected to finance the government, whatever size it is decided by the government and whether those should be collected just from wage and salary income or whether people who have capital income, either through businesses or investment, should make a contribution to that. That is the choice this is making.

Mr. COLLINS. Everybody works off a bottom line and when you get to the bottom line of taxation, there is only one place to get it. That is from working men and women in this country.

Thank you.

Mr. KEATING. I agree. I strongly disagree with what Ms. Lav just said. The owners of capital are not the only ones that bear the cost of corporate income taxation. Indeed most economists do not agree how it is divided, but they would agree it is divided among capital owners, workers, and consumers.

How it is divided, I am not sure. I just wanted to disassociate our organizations from those comments.

Mr. COLLINS. But the truth of the matter is that if you don't have working men and women in this country working, making an income to spend that income, there is no cash flow.

Mr. BUNNING. Thank you, Mr. Collins.

I want to thank the panel for their patience and their contribution to the record and we really appreciate your staying so long and being so patient. Thank you very much.

[Whereupon, at 4:02 p.m., the hearing was adjourned.]

CONTRACT WITH AMERICA—OVERVIEW

THURSDAY, JANUARY 12, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met, pursuant to call, at 10:07 a.m., in room 1100, Longworth House Office Building, Hon. Bill Archer (chairman of the committee) presiding.

Chairman ARCHER. Could our guests take their seats as soon as possible. We will commence the committee hearing.

Today we begin the final overview hearing on the Contract With America. We have before us distinguished guests who will share their thoughts with us about the Contract. Several of these witnesses are Governors and mayors who are already moving forward in their own States cutting taxes and reducing spending, moving in the direction that we would like to take the country, which is smaller government, more efficient, leaner government.

I believe we can learn from their examples and I look forward to their testimony. As we did yesterday, and we will continue to do, we have a panel of American citizens from beyond the Washington beltway.

Yesterday we heard from four people who traveled to Washington to let us hear their thoughts about passing our Contract. I found and I believe all of our members found their testimony to be very helpful. Again today we are privileged to hear from what we might call mainstream, ordinary Americans including an immigrant to the United States who now lives in Illinois, a secretary from California, the director of the California Department of Social Services and a farmer from Michigan. They will be here later and I am grateful to them for joining us.

We will also listen to four highly respected experts representing the National Federation of Independent Business, the U.S. Chamber of Commerce, the National Association of Manufacturers, and the American Federation of Labor and Congress of Industrial Organizations.

Before turning to our witnesses, I would like to recognize my friend, the minority leader of the committee, for any statement that you might like to make.

Mr. Gibbons.

Mr. GIBBONS. Thank you, Mr. Chairman. I am going to yield at this time to Mr. Neal of Massachusetts.

Mr. NEAL. Thank you very much, Mr. Gibbons. Thank you, Mr. Chairman.

I would like to welcome our witnesses to the committee today. It is very important that we hear from individuals who represent our States and our cities. During the past few days, we have learned more about specific provisions of the Contract With America. We have heard from Treasury, economists, and real Americans.

We need to anticipate the impact the Contract will have in the end on cities and States. We need this knowledge to appropriately assist our States and our cities with all the challenges they face. Let me say I have never received a letter or a phone call from a Governor or from a mayor asking that they be allowed to return Federal funding.

As the former mayor of Springfield, I can relate to and understand the problems which confront you. Our urban areas have deteriorated in the last few years, and we certainly need to take bold action to make our cities livable again.

As I increase my learning curve about the Contract With America, I am concerned about several of its aspects and the impacts of the Contract on local governments. Treasury has estimated the cost of the Contract for 10 years to be $725.5 billion.

Several of the tax provisions do not provide elementary fairness. Fairness is the distribution of tax burden among families at different income levels. Fifty percent of the tax provisions of the Contract benefit families with incomes over $100,000. Are these the families who need our help? I agree with some of the tax proposals but they need to be targeted at the lower and middle class.

All of us are working to reduce the deficit. I think both sides of the aisle agree that this is our primary objective. We differ, however, on how we should reach this goal. Can we really afford to give broad tax breaks at this point in time? What positive impact will these tax breaks have on our cities? Again, I have never received a request from a mayor or a Governor to reduce their share of Federal funding.

One of the most important issues that needs to be addressed is the issue of welfare. I agree we should end welfare as we know it. However, I am concerned about some of the proposals that have been included in the Personal Responsibility Act. For instance, the legislation consolidates various nutrition programs including food stamps; the Supplemental Nutrition Program for Women, Infants and Children; the school lunch and school breakfast programs into one block grant.

A block grant would not be an entitlement program but would be subject to the annual appropriation process. This change would result in an uncertainty of funding. This type of provision will result in a loss of funding for State and local programs that have been highly successful.

What is going to happen to Meals on Wheels and school lunch programs? Which one of us is prepared to tell our senior citizens that they will no longer receive Meals on Wheels? And it appears that this proposal will break a promise rather than create a contract with the American people.

The Personal Responsibility Act provides State flexibility. We support the concept of State flexibility and believe that we need to encourage States to be innovative. States need to develop programs that work in their particular region. In the area of child support, Massachusetts, under the leadership of Governor Weld, has been successful and should serve as a role model for the rest of the country.

When Secretary Shalala appeared before this committee, she told us improved child support collection would result in a 25-percent reduction in welfare expenditures. Massachusetts has increased its child support collection rate from 51 to 67 percent over a 3-year period. We need child support enforcement legislation at the Federal level. Unfortunately, child support enforcement is not adequately addressed by the Contract With America.

The Personal Responsibility Act would allow States to take themselves out of the current AFDC program and instead receive AFDC payments in the form of annual block grants. States would be required to follow minimal Federal standards. Under this proposal, Americans who meet eligibility requirements would no longer be guaranteed benefits. How will the reduction in benefits to the poorest among us help to improve our cities?

An appropriate type of program needs to be developed which does not permit States to be at-risk. We have to avoid a situation in which welfare recipients will shop from State to State looking for the best benefits.

Federal standards need to be in place to prevent disparities between States which would be harmful to the poor. There are some excellent training programs already in place in Massachusetts, and we should develop and expand upon these programs. We need to develop a program that provides the poor with the necessary skills and the training to become part of the work force. We cannot create a system that kicks those who are already down.

The more I reflect upon the Contract, I am concerned about its costs and how the Contract will be financed. The financing mechanisms of the Contract are very unclear. The Senate Budget Committee staff has a proposal which would require $22 billion in cuts in nondefense programs in fiscal year 1996 and entitlement savings of $41 billion.

Where will these cuts come from? What programs will become things of the past? According to yesterday's Boston Globe, the black infant mortality rate has reached the lowest level ever recorded. In Massachusetts, health officials credited Federal, State, and local initiatives in recent years in helping with the reduction in this racial disparity. However, more needs to be done. Should we decrease Federal initiatives that are just starting to show their success?

Financing of the Contract will surely result in future Medicare benefit reductions. The Contract will lower the taxes which are now deposited in the Medicare Trust Fund. How will our hospitals react to these changes? What happens when the Federal Government has trouble meeting these obligations? Massachusetts has some of the best hospitals in the world and we cannot sacrifice the quality of our health care.

Financing the Contract would result in cuts in Federal support for mass transit. These cuts would result in fewer transit routes, higher fares, or higher State and local taxes.

For an example, in Massachusetts, how will the State finish the central artery project and the cleaning of the Boston Harbor, the largest public works project in American history? Should we take away the ability of Governors to receive Federal funding for necessary State expenditures? Should we discontinue the successful partnerships between States and the Federal Government?

President Eisenhower's commitment to the Federal highway system is an appropriate model. Financing the Contract could result in a decrease to programs which benefit our cities. I believe the community development block grant program is one of the most successful Federal initiatives. Has one mayor ever offered to return a dime of this funding?

Cities throughout the country are currently receiving community policing grants. How many of the mayors would return this financing?

Springfield was one of the cities to be designated as an enterprise community. The city has a well-thought-out plan to use the $3 million. Are we going to stop supporting this type of program in order to pay for the Contract?

Financing the Contract would result in the loss of successful and valuable programs. What would happen if Federal support ceased for school lunches for families with incomes of $22,000 for a family of three? The price of school lunch for those children would increase at least 30 cents a day. How will this help our children?

I think we all agree today that changes are needed and we need to take the action now to help our old cities. But are the benefits of the Contract the right approach? Is the Contract With America really worth its underlying costs? Can cities really manage without support from the Federal Government?

I am still waiting for that phone call from any mayor or any Governor who wishes to refuse Federal support. I look forward to this testimony and having many of these questions addressed.

I thank you, Mr. Chairman.

[The prepared statement follows:]

Congressman
RICHARD E. NEAL

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Wilbraham

January 12, 1995
Opening Statement by Mr. Neal of Massachusetts
Hearing on the Contract With America

Mr. Chairman, I would like to welcome our witnesses to the Committee today. It is very important that we hear from individuals whom represent our states and cities. During the past few days, we have learned more about specific provisions of the Contract With America. We have heard from Treasury, economists, and "real Americans." We need to anticipate the impact the Contract will have on states and cities. We need this knowledge to appropriately assist our states and cities with all the challenges they face. <u>I have never received a letter or phone call from a governor or mayor asking to return federal funding!</u>

As the former Mayor of the City of Springfield, I can relate to and understand the problems which confront you. Our urban areas have deteriorated in the last few years and we need to take bold action to make our cities livable again.

As I increase my learning curve about the Contract With America, I am concerned about several of its aspects and the impact of the Contract on local governments. Treasury has estimated the cost of the Contract for ten years to be $725.5 billion. Several of the tax provisions do not provide elementary fairness. Fairness is the distribution of the tax burden among families at different income levels. Fifty percent of the tax provisions of the Contract benefit families with incomes over $100,000. Are these the families whom need our help? I agree with some of the tax proposals, but they need to be targeted at the lower and middle class.

All of us are working to reduce to the deficit. I think both sides of the aisle can agree this is our primary goal. We differ on how we should reach this goal. Can we really afford to give broad tax breaks at this point in time? What positive impact will these tax breaks have on our cities? <u>Again, I have never received a request from a mayor or governor to reduce their share of federal funding.</u>

MASSACHUSETTS' SECOND DISTRICT

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One of the most important issues that needs to be addressed is welfare. I agree we should end welfare as we know it. However, I am concerned about some of the various proposals that have been included in the Personal Responsibility Act. For instance, the legislation consolidates various nutrition programs including Food Stamps; the Supplemental Nutrition Program for Women Infants, and Children (WIC); and the school lunch and school breakfast programs-into one block grant. The block grant would not be an entitlement program, but would be subject to the appropriation process. This change would result in uncertainty of funding. This type of provision will result in a loss of funding for state and local programs that have been very successful. What is going to happen to Meals on Wheels and school lunches? Which one of us is prepared to tell senior citizens they are no longer entitled to Meals on Wheels? It appears the proposal would break a promise rather than create a contract with the American people.

The Personal Responsibility Act provides state flexibility. I support state flexibility, and the belief that we need to encourage states to be innovative. States need to develop programs that work for their particular state. In the area of child support, Massachusetts, under the leadership of Governor Weld, has been very successful and should serve as a role model for the rest of the country. When Secretary Shalala appeared before this Committee, she told us improved child support collection would result in a 25% reduction in welfare expenditures. Massachusetts has increased its child support collection rate from 51% to 67% over a three year period. We need child support enforcement legislation at the federal level. Unfortunately, child support enforcement is <u>not adequately addressed in the Contract</u>.

The Personal Responsibility Act would allow states to take themselves out of the current AFDC program and instead receive AFDC payments in the form of an annual block grant. States would be required to follow minimal federal standards. Under this proposal, Americans who meet certain eligibility requirements would no longer be guaranteed benefits. How will a reduction in benefits to the poorest among us help our cities improve? An appropriate type of program needs to be developed which does not permit states to be at risk. We have to avoid a situation in which welfare recipients will shop from state to state looking for the best benefits.

Federal standards need to be in place to prevent disparities between states which would be harmful to the poor. There are some excellent training programs already in place in Massachusetts and we need to expand upon these programs. We need to develop a program that provides the poor with the necessary skills and training to become part of the work force. We cannot create a system that kicks those who are already down.

The more I reflect upon the Contract I am concerned about its costs and how the Contract will be financed. The financing mechanisms of the Contract are unclear. The Senate Budget Committee Staff has a proposal which would require $22 billion in cuts in non-defense programs in FY96 and entitlement savings of $41 billion. Where will these cuts come from? What programs will become things of the past?

According to yesterday's Boston Globe, the black infant mortality rate has reached the lowest level ever recorded in Massachusetts. Health officials credited federal, state and local initiatives of recent years in helping with the reduction in racial disparity. However, more needs to do be done. Should we decrease federal initiatives that are just starting to show their success?

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Financing the Contract would result in cuts in federal support for mass transit. These cuts could result in fewer transit routes, higher fares, or higher state or local taxes. For example in Massachusetts, how will the state finish the central artery project and the cleaning of Boston Harbor? Should we take away the ability of governors to receive federal funding for necessary state expenditures? Should we discontinue the successful partnerships between states and the federal government? President Eisenhower's commitment to the federal highway system is an appropriate model.

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Financing the Contract would result in the loss of successful and valuable programs. What would happen if federal support ceased for school lunches for families with income above $22,800 for a family of three? The price of a school lunch for these children would increase at least 30 cents a day. How will this help our children?

I think we can all agree changes are needed. We need to take action now to help our cities. But are the benefits of the Contract the right approach? Is the Contract with America really worth its underlying costs? Can cities really manage without support from the federal government? I am still waiting for a phone call from any mayor or governor refusing federal support.

I look forward to hearing the testimony and having my questions answered.

Chairman ARCHER. I thank the gentleman for his statement. Without objection, any other statements that might be desired by members of the committee can be inserted in the record in writing.

[The following was subsequently received:]

STATEMENT OF REPRESENTATIVE JIM RAMSTAD
WAYS AND MEANS COMMITTEE
HEARING ON THE CONTRACT WITH AMERICA
January 12, 1994

Mr. Chairman, I want to thank you for holding this excellent set of overview hearings on the Contract with America. This committee has certainly benefitted by hearing from a wide range of witnesses like the impressive panel before us this morning.

I am especially looking forward to the testimony from the state and local officials who are with us today. Time and again, Republicans have emphasized that Congress and the federal government have much to learn from accomplishments at the state and local levels.

Across the country, we are seeing state and local governments enact more innovative welfare reform, privatize more government functions and cut spending and taxes farther and faster than the federal government.

Governors and mayors can tell us what tax and welfare reforms work because they've already implemented them.

More importantly, I hope they tell us what hasn't worked because the federal government, with its over-reaching regulations and mandates, has gotten in the way.

I am also grateful that several citizens have volunteered their time to travel to Washington and speak before this committee. We need to hear more from Americans who pay the taxes, run the small businesses or care for loved ones who are ill. Only then can we understand the true impact of the reforms in the Contract with America and why they are so desperately needed.

Finally, I am pleased we will hear from several experts on business policy. Too often, past Congresses ignored or disregarded the fact that pro-business legislation and policy is essential for long-term economic growth and job creation.

Burdensome government regulations and mandates have had a profoundly negative impact on American business -- especially the small businesses which create 80 percent of the new jobs in this country.

I thank you all for being here today and look forward to your testimony.

CONGRESS
of the
United States of America

Ways and Means Committee

Andy Jacobs, Jr.

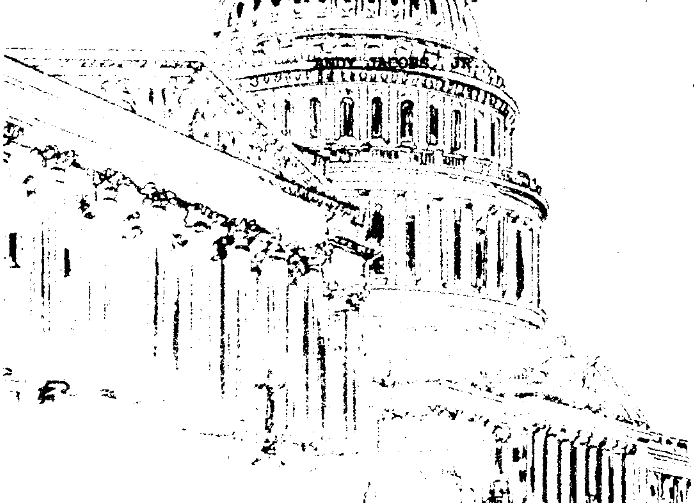
January 11, 1995

MR. CHAIRMAN:

I am pleased that Mayor Goldsmith is testifying before the Ways and Means Committee today.

I had the privilege of sitting with him at the witness table when he testified awhile back at the Public Assistance Subcommittee. It is not extravagant to say that Steve Goldsmith dazzled both Democrats and Republicans on the Subcommittee with his extemporaneous testimony. I believe the entire Ways and Means Committee will be equally impressed today.

ANDY JACOBS, JR.



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THE ROAD TO PEACE IS PAVED WITH JUSTICE

Chairman ARCHER. We should ask probing questions as we move along in our deliberations so that we will have a product that is the very best that we can make. We need to understand that perhaps the greatest enemy of our effort is perfection. Perfection is the greatest potential enemy of improvement, good and even the best.

Now I would like to recognize my colleague from New York, Mr. Rangel, to make an introduction.

Mr. RANGEL. Thank you, Mr. Chairman. In that search for perfection, I would like to introduce our newly elected Governor, a person who has served as mayor of the great city of Peekskill, was an outstanding State Assemblyman and Senator in the State of New York and has demonstrated a willingness to work in a bipartisan way with local and State officials, and we look forward to hearing his testimony.

And I would like to yield to my colleague, Mr. Houghton.

Mr. HOUGHTON. No further words. We are delighted to have you here, Governor. Thanks very much.

Chairman ARCHER. Before we commence the testimony, the audience and members of the committee should know that Governor Weld is not here because he is caught in a snowstorm in his home State. He is on his way, and we hope that he will get here before we complete our proceedings today. I am very happy when I hear about these things that I come from Houston, Tex., instead of from Massachusetts.

We are particularly delighted to have two Governors already with us today, Governor Dean of Vermont who needs no introduction and has received a great deal of publicity lately in some of his efforts to make this a better world. We normally have a rigid 5-minute rule on oral testimony with the ability to insert your written remarks in the record in full. I am not going to ask you to adhere precisely to that, but I would hope that you would keep your oral testimony as brief as possible so that we will have more time for questions.

Is Governor Pataki here?

STATEMENT OF HON. GEORGE E. PATAKI, GOVERNOR, STATE OF NEW YORK

Governor PATAKI. Thank you, Chairman Archer, and Congressman Houghton and Congressman Rangel and distinguished members of this committee.

I appreciate this opportunity to testify today before this panel as Congress prepares to act on the House Republicans' Contract With America. As the new Governor of New York, I am heeding our citizens' call to cut taxes, cut spending and control government. I look forward to working with Congress to assure that we travel the road to reform together.

I have prepared remarks that we will submit as a part of the record, Mr. Chairman. But rather than recite them at this point, let me just briefly outline to the members of this committee what we intend to do and what we would like to see happen here in Washington.

I am in the process of putting together my first budget. We are going to reform and change our Medicaid system dramatically. We are going to look to put in place things like mandatory managed care.

And, Congressman Neal, I listened to your comments where you said you haven't heard a Governor or a mayor come here and say we are giving back some money to Washington. We intend to lower the cost of Medicaid in New York State dramatically this year and lower the cost to Washington to you to the tune of $2 billion. That would result in a $1 billion savings to the taxpayers of the State of New York and almost equal savings to the local governments in the State of New York and a $2 billion, approximately, savings here in Congress. We are going to be returning those funds or not claiming those funds that otherwise would have come to New York by virtue of our Medicaid reform package that we hope the legislature will support.

We are also looking to dramatically restructure welfare in New York State. We are going to have workfare, mandatory workfare put in place all across New York State. We are going to put in place front-end detection systems, computerized programs to reduce fraud and waste in the claims that are made inappropriately against the public Treasury. And we are going to look to put in place learnfare across New York State to encourage responsibility and give our children the chance through an education to avoid the cycle of dependency and become productive members of our society.

Now let me say what we would like you to do here in Washington. First, I do not fear the balanced budget amendment. I think it is a very good thing. I wish it had been in place here in Congress 20 years ago because I think we all would have been in a better position. We as Governors have to balance our budgets. We are looking in New York State at a $5 billion-plus budget gap. We are going to balance it. We are going to make tough decisions and tough choices, but that is what government should do and that is why we are elected. So I do not in any way fear the balanced budget amendment. I would like to see Congress pass it and impose discipline so that my children and grandchildren aren't saddled with the debts of this generation of elected officials.

Having said that, I think it is very important that Congress achieve a balanced budget without shifting costs and shifting programs from the Federal Government to the State government. In our process in Albany, we are looking to spend less money in absolute dollars in the upcoming year than we did in the past year. But we are looking to do that in a way that doesn't shift the cost of programs down to the local governments or the county governments.

We need to control government. We don't need to pass the buck from one level of government to another. So as you move toward a balanced budget here in Washington, we request that you don't shift the cost to local governments to State governments, but continue the support that is necessary and, in that sense, we think the absence of unfunded mandates, the requirement that mandates imposed by Washington be fully funded, is extremely important.

Third, there is talk about block grants to give greater flexibility to the States. I welcome that as well. I think as we have seen, the welfare systems of the States are very different, the populations, the needs are very different, and I would like to see us have maximum flexibility at the State level to tailor our programs to the needs of the people in our State.

Again, having said that, we want to see those block grants recognize the historic level of commitment in spending and support from the Federal Government and don't want to see those block grants cut the amount of support that comes from Washington to New York State or any of the States cut as you move toward a balanced budget.

And I know, in the context of block grants, there is some question, do we impose programs like workfare? Do we require States to have certain elements in their welfare programs? Let me make a suggestion that rather than mandating on the States that block grant package, have built-in incentives so that you would get a higher level of block grant if you achieve certain goals that Congress believes are appropriate for us as a society, such as moving people toward workfare or achieving a rate of error in eligibility that is below a norm set by Congress so that you could have a basic block grant, but that States that then achieve certain additional goals that Congress thinks appropriate, could achieve—could receive even more funds from Congress so that the Federal Government could reward States that have programs like workfare, front-end detection, and learnfare by having higher block grant appropriations.

A couple of other things you could do for us. When I talk about that $2 billion in savings to the Federal Government, by the changes we are looking to make in Medicaid, many of those changes require Federal waivers. We are concerned that those waivers either won't be granted or, if they are granted, it will take anywhere from 6 months to 1 year to achieve those waivers.

Why not in programs such as mandatory managed care where States like Rhode Island have already obtained waivers, allow States to have those waivers quick, if not automatically, quickly, so that we could begin moving toward those programs right away instead of having the 6 months to as much as a 1-year delay waiting to see whether or not that waiver is granted.

And second, when I talk about our Medicaid changes, it is something where I as Governor will be proposing them, but we need the support of the legislature to achieve those changes. It would be great, it would be in the interests of New York State, it would be in the interests of Congress if there were incentives built into the reimbursement rates for programs like Medicaid for States that reduce their level of expense.

Right now, in New York State, we get approximately a 50-percent reimbursement for our Medicaid program from Washington. Some States get reimbursement levels as high as 80 percent. If we are going to restructure our Medicaid program to achieve these savings, it would help me to get legislative approval, and I think it would help you to have more States moving toward reforming the systems in a way that would lower the costs if you would share some of those savings with the States. And one example would be in the form of a higher reimbursement rate so that we would move above 50-percent Federal reimbursement for Medicaid as we lowered the cost of that program to the people of the State and the people of the country.

So we have a very ambitious agenda in New York State. I am sure it is very different from the agenda of Governor Dean and our neighboring State of Vermont in many important ways because, while we have similarities, we have many differences and that is why I think the flexibility that the Contract With America talks about, the block grant approach are some things that would allow us to tailor our programs to meet the needs of our individual States.

So, Mr. Chairman, I thank you for this opportunity and for the chance to speak to you this morning.

[The prepared statement follows:]

TESTIMONY OF
THE HONORABLE GEORGE E. PATAKI
GOVERNOR OF THE STATE OF NEW YORK
TO
WAYS AND MEANS COMMITTEE
UNITED STATES HOUSE OF REPRESENTATIVES
JANUARY 12, 1995

Mr. Chairman, Members of the Committee:

I appreciate the opportunity to testify today before this distinguished panel as Congress prepares to act on the House Republicans' "Contract with America."

As the new Governor of New York, I am heeding our citizens call to cut taxes, cut spending, and control government. I look forward to working with Congress to be sure that we travel the road to reform together.

Cooperation on the course that change will take is especially important as we work to reform welfare. There may not be a single solution to the problems posed by the existing welfare system, but the search for solutions demands a united effort in Washington, in the state capitols and in city halls and town halls across our nation.

Given the complex array of programs and policies collectively known as welfare, it is obvious that no single solution will be found.

And considering the diversity of the people that welfare attempts to serve, it is equally clear that no single solution will work.

Yet, as we search for the best solutions, we should begin by agreeing to this point: Welfare isn't working.

Despite its noble intentions, welfare has only kept the poor from prospering. What began as a safety net has become a spider web, trapping the needy in a stranglehold of dependency.

The experience of New York and the nation, after more than a generation of new and bigger welfare programs, has taught us a valuable lesson about compassion. We have learned that we cannot view compassion as a commodity. It cannot be purchased with tax dollars, packaged like a gift and delivered by the government.

Real compassion, a truly caring approach to helping the needy, requires public policies that protect and preserve personal freedom and restore individual responsibility. When government takes responsibility for people, people stop taking responsibility for themselves.

In New York, we have a proud tradition of caring and compassion for our citizens most in need. As we begin our efforts to reform welfare in New York State, we are working to honor that tradition by honoring the dignity of work.

As we strive to replace welfare with work, New York will emphasize policies that recognize effort and reward achievement. In New York, we know that welfare reform requires tax reform.

Tax policies should not punish people for getting off welfare. The highest marginal tax rate in this nation is paid by people moving from welfare rolls to private payrolls. This terrible tax disincentive must end.

In Albany, I am pushing to lower New York's bottom tax rate, accelerate the benefits of New York's Earned Income tax credit, and institute a Family Tax Credit that would triple the tax benefits for child and dependent care. These steps will cut taxes for the working poor in New York State.

In Washington, Congress must take similar steps to reform the federal tax code in ways that reward people who leave the welfare rolls and go to work.

In New York, our welfare reform efforts have a clear, concise goal: Workfare must replace welfare.

Our effort to transform welfare into workfare starts with the conviction that welfare should not be a way of life. It should be a way for people to get temporary assistance, but it must also put people on the path to the dignity of self-sufficiency.

In New York State, there is a state/local program of public assistance called Home Relief. It is a program for needy New Yorkers, generally single and without children, who are not eligible for AFDC.

Various county governments within New York State have been putting Home Relief reform measures to the test. Westchester County, for example, has shown impressive results with a program called Pride in Work.

It involves rigorous initial checking to assure that all applicants are eligible. That step should be basic to any assistance program. No one -- conservative, moderate or liberal -- wants to be ripped off. I know that New Yorkers, who are as generous as any people on earth, resent people getting what they are not entitled to. Government has a clear obligation to do everything it can to eradicate fraud.

The Pride in Work program goes far beyond that first, basic step. All Home Relief recipients are assessed to determine if they are employable. Those capable of working are assigned to a public works job. Those deemed temporarily unemployable because of drug, alcohol, health or mental health problems are referred for treatment. Those determined to be permanently unemployable are referred for SSI or disability reviews.

In every case, appropriate review and action is taken. In no instance is it acceptable to let welfare become simply a routine matter of handing out checks. Those who can work are put to work. Those who need treatment receive it. Those with needs that cannot be served by Home Relief are referred to other programs.

Compliance is closely monitored, reported and tracked through Westchester County's computer system. Once word gets out that the Pride in Work contract of mutual responsibility is taken seriously, some individuals -- unwilling to enter into it -- never show up to apply. And those who do enter into it know there will be consequences if they fail to fulfill their end of the contract.

That is a brief description of the Pride in Work program. Westchester County has shown that welfare reform works. It works for the participants. It works for the community. It works for the taxpayers. For that reason, New York State plans to repeat the success of the Pride in Work program all across our state, in every county, as we work to reform New York State's Home Relief program.

The principles of welfare reform that New York is applying to Home Relief also apply to the AFDC program.

One significant addition to our credo in this regard is the tenet that both parents are responsible for supporting their children. Welfare reform must be innovative and aggressive in the enforcement of child support.

Welfare reform must also insist, through a learnfare program, that parents accept the responsibility of being involved in and concerned about their children's education. It is as true now as it has always been that education is one of the surest routes out of poverty.

The AFDC population is larger and more diverse, with the typical case presenting a more complex set of needs than the typical Home Relief case. Nonetheless, welfare reform must include a workfare requirement for AFDC. Everyone should be doing <u>something</u> to move themselves toward the next step, up the next rung on the ladder. Welfare <u>recipients</u> must become <u>participants</u>.

I am very aware, as a Governor who is preparing to present his state's budget plans at the beginning of February, of the need to reduce the cost of government, to eliminate wasteful spending, to eradicate fraud and abuse of tax dollar. The citizens of New York and this nation know that government, at all levels, has grown too large and too costly.

In New York, I am asking our local governments to be partners for change with state government. An essential element of that partnership is trust. I believe state government can trust counties, cities, towns and villages to fulfill their responsibilities without additional mandates from Albany. And New York's local government are trusting the state to end unfunded mandates.

New York State is ready to be the federal government's partner for change. And we are looking for an end to unfunded mandates as an essential element of that partnership.

Unfunded federal mandates cost New York State government more than $3 billion per year and they cost local governments in New York another $3 billion annually. We know we need mandate relief from Washington to confront New York's long-term budget problems.

So, I must emphasize the point I made at the start. There is no single answer to the welfare woes of this nation. A one-size-fits-all welfare reform just won't work. Tax reform, mandate relief and flexibility to allow local solutions to local problems are the watchword for welfare reform.

Welfare reform that focuses on personal responsibility and individual liberty can do what Americans have always done better than anyone in the history of the world: Give the next generation more hope, more opportunity, more freedom.

In New York, we strive for that American ideal with enthusiasm and energy. We will work to eliminate any state or federal welfare regulation that devalues work, discourages marriage or undermines family life. We will decentralize where we can, privatize where it makes sense, and count on communities to innovate in ways that best meet the needs and values of their citizens.

We will do it not to punish nor to pacify. We will do it because it is our responsibility, as protectors of the public trust, to pursue programs and policies that protect the freedom of our citizens to prosper and restores the individual's responsibility to exercise that freedom.

As I stated at the outset, I look forward to working with Congress as we all move forward to answering our citizens' call for change, by cutting taxes, cutting spending, and controlling government.

Thank you.

Chairman ARCHER. Governor, your testimony is very refreshing to this member and I think to most of the members of this committee, if not all. I can assure you that as you walk through the Capitol today, you will find a fresh spirit afoot to implement the Federalism which has been the basic tenet on which this country was founded. There is a high regard and a high respect for the authority and the responsibility of each State to meet the diverse requirements that exist across the land in this great country. You have articulated that which is why we are pleased to have Governors before us today as we reach out and tell the Nation that we want to return power to you because we believe, in many, if not most, instances, you can do it better than we can from on high up here in Washington.

Governor Dean, we would be pleased to hear your comments to the committee.

STATEMENT OF HON. HOWARD DEAN, M.D., GOVERNOR, STATE OF VERMONT, AND CHAIRMAN, NATIONAL GOVERNORS' ASSOCIATION

Governor DEAN. Thank you very much, Mr. Chairman. Let me say that I am extremely gratified and pleased to be asked to testify. I think it is very important to hear from the loyal opposition as we are now in the National Governors' Association as well as in Congress.

I have a lengthy written testimony which I will file for the record. While the written testimony that I file is not necessarily the position of the National Governors' Association, the remarks have been approved by both Republican and Democratic members, and so I will summarize and then I will——

Chairman ARCHER. Without objection, your entire testimony will be printed in the record.

Governor DEAN. Thank you very much, Mr. Chairman. I will summarize quickly so that we can go on to some questions and then make some remarks speaking as Governor of Vermont.

The other thing I would just wish to say before I start is that you will find that Governors generally—usually, although perhaps not as recently, operate on a bipartisan mode and that many of the views that Governor Pataki expressed are views that I share and are views that many Governors, both Democrats and Republicans, share. There are some differences in the details but not a lot of differences in the direction.

First, let me say that in terms of unfunded Federal mandates, we do have policy. We support the unfunded mandates bill that was in the Senate or went through the committee yesterday and are very appreciative of this body, and we don't want to see any changes in that.

Let me address the welfare bill, the personal responsibility bill. We do have policy at NGA, but no position on the Personal Responsibility Act. I am just going to read quickly some of the things that we have set off as bipartisan: Welfare is a transition to self-sufficiency; assistance for those not yet ready for employment or training; time-limited cash assistance, including education and training to help recipients prepare for work; improved child care and earned income tax credits for low-income working families; enhanced interstate child support enforcement; expanded programs to encourage family stability and limit teen pregnancy; and improved coordination between AFDC and food stamps programs. That is the bipartisan National Governors' policy.

Let me address very quickly welfare reform and the approach that is in the Contract. I think the vast majority of Governors, both Democrats and Republicans, believe that work ought to be a requirement for able-bodied recipients. I think the vast majority, both Democrats and Republicans, believe time limits are appropriate and job requirements after those time limits are appropriate.

I think where we have significant differences of opinion are—let me just say that the vast majority of Governors agree with the notion of block grants and increased State flexibility.

I speak as the Governor of the only State in the country that in fact has a statewide welfare reform program which incorporates both time limits and work requirements. We had to get a waiver for that. We would hope that under the legislation that comes out of this body, that those waivers—kinds of waivers will no longer be necessary, but our experience is somewhat different and somewhat at odds with what has been proposed recently in this Chamber.

First of all, we believe that welfare reform does not save money. We have had a terrible recession in the Northeast which we are just barely excelling out of and we have had to create public service jobs in order to find places to put people. Since there are people who were in the work force who can't find work, we naturally—the people who are in the work force who are on welfare are having an even more difficult time finding work, and we have created low-wage jobs in places like nursing homes, schools, libraries and so forth either for the State or mostly for nonprofits, and they will get welfare grants for those jobs if they cannot—if they cannot find a job in the private sector.

We prefer them to find a job in the private sector. There is child care and training and so forth. If they can, we think it is very important that they work and that the job in the private sector—in the public sector or the nonprofit sector be the appropriate way to deal with that. That costs money.

Second, the Democratic Governors have a great concern with the notion of breaking the entitlement and that is why. We believe that welfare is a national issue and this is a nation and it is not just simply a collection of 50 States. While we very firmly want to support you, Mr. Chairman, and the others in the leadership who are moving toward a more flexible situation with welfare, we believe there ought to be some sort of a national standard and we also—minimum standard.

And we also believe that if the entitlement is completely broken and block grants are level funded over the next several years, the first time there is a recession the States will then be forced to choose between a tax increase or literally putting people in the street, and the majority of the welfare caseload is of course children. That is something I don't believe is in the Nation's interest or the State's interest, so that is a major concern.

We are very interested in exploring how we might cope with the paternity question, and we applaud the leadership not for its particular suggestion, but for putting that issue on the table. It needs to be resolved. We need to do much more in that area and we need to make it clear that fathers have equal responsibility in terms of providing for their children.

Let me just close this section by saying there is a significant amount of interest as opposed to rejection of Senator Kassebaum's initial proposal for swaps. Initially she proposed that the Federal Government would take Medicare and the States would get welfare. Governors I think of both parties are uncomfortable with that, not wanting to create one giant bureaucracy at the Federal level to handle health care.

There is now a proposal I believe she has advanced that the Federal Government would take primary responsibility for long-term care and disabled children and that the States would take primary responsibility to the acute care Medicaid and welfare that is a very attractive proposal for us, frankly, because even if funds are limited, they allow States to experiment without having to go through the waiver process with further health care reform, something many of us are extremely interested in.

Let me just conclude by talking about the tax cuts and the balanced budget amendment. The National Governors' Association, I think it is fair to say that although we don't have an official position on the balanced budget amendment, that most Governors, including myself, are in favor of a balanced budget amendment. We understand, and I think Governor Pataki made the point quite adequately, that we have got to balance the Federal budget and that is a severe problem for all of us and for our children.

The Democratic Governors have taken a position that, because of our past experience, we would prefer very strongly to see language in the balanced budget amendment, which require the same kinds of approach to unfunded mandates that you have in legislation. That would guarantee that a future Congress would have a good deal of trouble undermining that.

We do have trouble, however, or I do have trouble—and now I have to depart from my role as the National Governors' chair—with what might happen under the current scenario. And let me emphasize that I am speaking for myself and not necessarily any other Governor.

If you have a balanced budget amendment and if you take Social Security and defense, of course the national debt, off the table—I have a table that I am ready to share with you that I got from the Treasury Department last night which shows that the majority of the cuts would then have to come from programs, obviously, that are not off the table and those would include a large cut in all State moneys that go to us.

We have estimates, and I will share these with the committee, that New York State, for example, not including the tax cut proposals in the Contract would lose $10 billion. If Governor Pataki were not able to have any reforms at all that would cause him to have a 17-percent tax increase. If he institutes some of his reforms, unless he can find a way to save $10 billion, without even addressing his $5 billion shortfall or his tax cut, he has to raise taxes. I don't think Governor Pataki wants to do that, nor do I.

California would be short $7 billion. Texas would be short $4 billion at current service levels. Vermont, the numbers are much less, smaller, but our entire Medicaid allocation for acute care would be wiped out and all we would be able to pay for—given across-the-board cuts and that includes the same equal cuts in Medicare, veterans pensions and other things that are going to be difficult for Congress to cut given across-the-board equal cuts to State revenues as well as some of the Federal programs that are not taken off the table—we would lose all of our acute care portion of the Medicaid and only be able to pay for long-term care. That is a real problem.

A number of Governors, both Republicans and Democrats, were elected promising tax cuts. If the Federal Government cuts taxes, the numbers are even higher. The numbers for New York are $11 billion. For California, $10 billion. This is a significant problem.

There are a number of us—but I will again speak for myself—who have problems with the nature of the tax cut proposed by the Federal Government. The tax cut proposed in the Contract appears to be loaded toward the income group that is above $100,000 a year, particularly the capital gains and the changes in the real estate tax.

If we are talking about Federal tax cuts and not very large cuts to State programs, let's just suppose we can be more efficient and cut some full things we agree we can cut. I think it is unlikely that we are going to be able to cut this to that degree because we are talking in some cases about 30 percent of our Federal entitlements, but we may have to raise taxes, particularly if there is a recession, we will have to raise taxes.

If we have to raise taxes, first of all, we would be very resistant to doing so. Second, if we have to raise taxes, our tax structure is such that the middle class will bear the brunt of the tax increase. Our income taxes are not as progressive as those for most States. I think New York and Vermont are perhaps exceptions to that because we compete with each other and can't afford to raise our income taxes but our sales taxes and our gasoline taxes and all those other taxes that we use are taxes that fall very heavily on the middle class.

So it is conceivable if the tax cut were passed as currently configured in the Contract or recently what would happen is that you would have a tax cut that would principally hit people over $100,000 at the Federal level and be made up for at the State level by taxes which principally hit people under $100,000. I don't think that is the intention of the leadership but that is the mathematics as we see it.

So we support a balanced budget amendment and we think it has to pass. We hope there is mandate language in the amendment. We, I think, probably will not be able to come to a conclusion in the National Governors' Association about the tax cuts. We are very, very concerned about the impact on States.

And I just will, as a final paragraph, I don't think it is fair to undermine somebody else's proposal without putting a few things on the table. And let me say that I believe everything has to be on the table, including Social Security. I do not believe you need to cut Social Security, but I do believe you need to look at the retirement age. The life expectancy of recipients has gone—expanded dramatically since the thirties when the program was created.

We have to look at everything because, if you don't look at all the Federal programs including Social Security and defense, you are simply going to pass a much bigger hit to the State governments and force middle-class people, working people to pick up the tab.

So my suggestion would be that we look at these block grants very carefully, that we not throw out the good programs with the bad. For example, food stamps we think there are a lot of problems with and encourage discussion of block granting and so forth. School nutrition programs we think are an excellent program. They have served very well. They are essentially a noncash program serving the neediest and most helpless people in society which are small children who are hungry.

Leave the nutrition program, the school lunch and breakfast program alone. Let's talk about block granting food stamps, but let's leave the programs alone that work well and let's concentrate our fire on those programs that clearly do not work and restructure those as we go along.

I thank you, Mr. Chairman, and I will submit my testimony for the record.

[The prepared statement and attachments follow:]

**STATEMENT OF HON. HOWARD DEAN, M.D.
GOVERNOR, STATE OF VERMONT
THE NATIONAL GOVERNORS' ASSOCIATION**

Mr. Chairman, thank you for the opportunity to appear before you today to discuss the Governors' perspective on the Contract with America. Implicit in the Contract is a major realignment of the relationship between state and federal government. The National Governors' Association (NGA) has strong policy advocating such a realignment and we would welcome the opportunity to work closely with you as you decide these major federalism issues.

My comments will focus on five areas:

1. Unfunded federal mandates;
2. the Personal Responsibility Act;
3. the Balanced Budget Constitutional Amendment;
4. the potential fiscal impacts of devolvement to the states; and
5. several recommendations on how to proceed.

Unfunded Federal Mandates

The unfunded mandates bill, H.R 5, is completely consistent with NGA policy and Governors strongly support this proposed legislation. It is a very workable bill that requires the Congressional Budget Office (CBO) to estimate the costs of mandates and the Congress to specify funding sources. It exempts constitutional rights, civil rights, and disability and handicapped legislation. (The bill sunsets any new mandates if no funding is provided or reduces the extent of the mandate to the level of funding at the agencies discretion.) We believe that this bill will go a long way toward alleviating the mandate problem in the future. The bill also initiates a study to look at existing mandates. The Governors support this bill as currently drafted and would strenuously oppose any weakening amendments.

The Personal Responsibility Act

At present, the National Governors' Association (NGA) has no position on the Personal Responsibility Act, but our current policy, was adopted in July 1993, lays out a framework for welfare reform that calls for:

- welfare as a transition to self-sufficiency;
- assistance for those not yet ready for employment or training;
- time-limited cash assistance, including education and training to help recipients prepare for work;
- improved child care and earned income tax credits for low-income working families;
- enhanced interstate child support enforcement;
- expanded programs to encourage family stability and limit teen pregnancy; and
- improved coordination between the AFDC and food stamps programs.

In addition, the Governors have called for increased flexibility in welfare programs. We believe there is no one-size-fits-all solution to welfare, and states must have the flexibility to develop programs and services that will address the unique characteristics of their welfare populations and economic conditions within their individual states. Reform efforts should:

- afford states specific options to try different approaches to designing welfare programs without having to apply for waivers;
- allow states to complete the welfare demonstrations currently underway through waivers and to allow future experimentations;
- allow states flexibility to decide how to phase-in time limits, and expand target populations; and
- leave room for states to try many different paths to job creations.

Finally, the Governors have supported a role for federal financing including:

- full federal funding of any mandates and no new costs or a shift of federal costs to states, counties, and localities;
- recognition of the federal responsibility to provide for the long-term care needs of children and of persons who are physically or mentally disabled; and
- maintenance of the federal level of investment in new technology and training in order to achieve welfare reform.

During the next several weeks we will be discussing the welfare reform issue to see if our current policy should be amended or modified. These discussions will help to prepare for the welfare meeting with the President and Congressional leadership on January 28th, as well as our Winter Meeting the last three days of January. This is a key issue to every Governor, however, and we look forward to working with you on a bipartisan basis once we have completed a comprehensive review of alternative approaches and have finalized any policy changes.

A Balanced Budget Constitutional Amendment

Currently, the NGA has no specific policy on the balanced budget constitutional amendment. There is concern, however, that states may also need mandate constitutional protection. Whether this is a separate amendment or part of the balanced budget amendment is an issue that is unresolved within the association. I will say, however, that whether or not the states ultimately ratify the balanced budget amendment may depend on how Congress addresses the mandate constitutional issue and how the Congress works with states over the next two years to realign federal-state responsibilities.

The Potential Fiscal Impact on the States

Mr. Chairman, you are considering a number of issues whose cumulative fiscal impact on the states is potentially huge over the long-run and therefore, I would like to make a few additional comments on these issues.

Tax Cuts. First, be aware that the federal tax cut that you are considering will translate directly into an additional revenue reduction for most states since most are linked to the taxable income definition in the federal tax code. The exact impact on our individual state revenues will differ by state and will depend on the nature of the tax cut. For example, since most states rely on the federal definition of income, a change in the deduction for children will have less impact than a change in the definition of taxable income. While NGA has no existing policy on potential tax cuts, you need to be aware that most states will not raise rates to compensate for the reductions in revenues which will automatically force budget reductions in many states. The extent of these cuts will, of course, depend upon the underlying growth in the economy. If the economy weakens next year, these cuts could be significant.

Collapasing Categorical Grants in Block Grants. Second, while NGA policy supports collapsing categoricals into block grants, we view this as a strategy to increase the efficiency and cost effectiveness of government. The administration of an excessive number of federal programs creates unnecessary costs at both the state and federal level. Moreover, the complexity of the categorical grant system discourages the development of coordinated community-based programs and often makes it difficult to secure the range of services needed to prevent or remedy complex problems. While some savings are certainly possible, substantial cuts in funding will result in substantial cuts in services or significant cost shifts to states and localities. This is a serious concern to the states.

Mr. Chairman, and members of the Committee, NGA is developing its own proposal to collapse the current state categorical grants into a small number of block grants. Such a proposal will have the advantage in having been extensively reviewed by all states. We hope that this proposal will be available in the next month. As Congress continues to consider the issue, I invite your members to meet with the NGA Executive Committee to negotiate the final structure and funding levels for these block grants. Block grants should increase government efficiency and preserve adequate federal financing for national concerns and priorities. Any approach that seeks to abandon those legitimate roles or to push unfunded national responsibilities on state and local governments will likely be opposed by most Governors.

Block Granting Low-income Entitlements. Finally, in order to meet your budget reduction goals in the next budget resolution, you also may be looking to make major changes in other low-income programs in addition to AFDC. In particular, I am referring to food stamps and Medicaid. With respect to food stamps, NGA is currently working to revise its policy and hopes to have a new policy adopted at the Winter Meeting. In Medicaid, we would appreciate the ability to do managed care without a waiver, relief from the Boren Amendment, but more imprtantly, we need greater flexiblity in setting benefit levels, eligibility, and developing the service delivery system.

At this time, NGA does not have policy in support of block granting any of these low-income entitlements to states. In fact, some existing policy could be interpreted to oppose such an approach. I would add that a number of Governors have concerns over breaking the individual entitlement of these low-income programs. We will, however, continue to review our policy positions on these issues and look forward to working with you as our policy evolves and the legislation continues to move through the House and Senate.

In summary, states have the primary responsibility for critical services of high priority to citizens. Already hard pressed to meet these needs, federal budget cuts that merely shift costs will merely increase public dissatisfaction. The adoption of a balanced budget constitutional amendment, cuts in categorical grants, federal tax cuts that translate into state revenue cuts, and restructuring of AFDC, food stamps, and Medicaid will have a significant impact on states. It is imperative, therefore, that those decisions be made in close consultation with states and with a full understanding of their true impact on the federal system.

Several Recommendatons on How to Proceed

If Congress is truly serious about realigning the state-federal relationship, then I would like to offer some guidelines.

1. <u>Start with a vision of what the federal-state relationship should be to maximize the various benefits.</u>

This should not be an ad hoc process. Instead, this is an opportunity to debate and realign the relationships between the federal and state governments. This would mean not only carefully defining the federal role, but also looking at potential swaps, such as having the federal government take over long-term care portions of Medicaid in exchange for other domestic responsibilities. Turnbacks of federal revenue sources, such as a portion of the federal gasoline tax, with some responsibilities, should also be part of this evaluation.

2. <u>Don't mix a budget reduction strategy with a realignment and devolution strategy.</u>

Consolidating the 600 categorical grants to a small number of block grants and restructuring welfare, food stamps, and Medicaid all may make sense from the standpoint of a federalism and efficiency in government. But, to do it primarily as a budget reduction exercise may well skew the final results and cause more long-run structural problems.

3. <u>Take the time to do it right.</u>

A realignment of federal-state responsibilities is very complicated and will cause significant programs changes at all three levels of government—state, federal, and local. This should be an open process where Governors, on a bipartisan basis, are at the table as full partners in any restructuring.

4. <u>Allow sufficient time for transition.</u>

The potential realignments may be significant and sufficient time should be allowed for states to accommodate changes. For example, states will have to change many state laws to accommodate the federal changes. Many state legislatures do not meet every year. A transition of severa years may be necessary for any major program changes. Also, if the federal role is to be reduced, states can better adjust if reductions are made over time. The impact of more efficient programs will be enhanced if the resources available for investment during the earlier years are preserved.

Mr. Chairman, again I appreciate the opportunity to be with you today on behalf of the nation's Governors. I am very serious when I say that we would like to work with you on a bipartisan basis as you restructure the federal-state relationship.

THE IMPACT OF A BALANCED-BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON STATE FINANCES

CONTENTS

Table 1
Spending Reductions under Balanced Budget Amendment, FY 2002 ($mil)

State	Cuts in Grants to State Governments					Required State Tax	Cuts in Other Federal Spending		
	Total	Medicaid	Highway	AFDC	Other	Increase	Total	Medicare	Other
U.S. Total	71,300	40,314	5,176	4,508	21,301	N.A.	176,492	77,475	99,017
Alabama	1,162	641	98	32	391	16.4%	3,058	1,157	1,900
Alaska	306	89	71	19	127	9.8%	576	44	532
Arizona	919	519	78	68	254	10.4%	2,397	949	1,447
Arkansas	723	416	65	16	225	16.5%	1,567	766	800
California	7,708	3,944	442	960	2,362	9.2%	20,321	9,101	11,220
Colorado	755	387	79	36	253	11.8%	2,764	721	2,044
Connecticut	1,008	587	105	63	253	11.2%	1,843	1,089	755
Delaware	158	70	18	9	61	7.2%	383	176	207
DC	697	183	17	24	473	20.4%	4,937	313	4,624
Florida	2,656	1,520	202	170	764	10.2%	9,782	5,336	4,446
Georgia	1,608	938	131	101	438	12.0%	3,790	1,392	2,398
Hawaii	328	117	62	24	125	6.8%	737	216	522
Idaho	254	118	33	8	95	9.9%	855	218	637
Illinois	2,576	1,354	174	155	892	11.6%	7,532	4,092	3,441
Indiana	1,490	956	123	54	357	13.8%	2,531	1,497	1,034
Iowa	630	328	69	35	197	10.9%	1,919	897	1,022
Kansas	622	355	52	29	186	13.0%	1,730	819	911
Kentucky	1,157	690	69	56	341	14.5%	2,111	952	1,159
Louisiana	1,966	1,500	94	48	324	27.8%	2,361	1,066	1,296
Maine	452	279	28	24	121	17.5%	717	385	331
Maryland	1,125	581	83	65	396	9.9%	6,253	1,377	4,876
Massachusetts	1,915	1,073	248	135	459	12.6%	4,683	2,449	2,234
Michigan	2,477	1,355	140	229	753	13.2%	4,988	3,333	1,655
Minnesota	1,177	679	102	83	314	9.4%	2,547	1,123	1,424
Mississippi	864	496	61	24	282	20.8%	1,672	713	959
Missouri	1,316	747	109	62	398	15.5%	3,942	1,781	2,161
Montana	277	123	52	12	89	19.8%	744	218	526
Nebraska	388	192	44	23	129	13.3%	1,213	482	732
Nevada	227	116	32	11	68	6.2%	1,005	258	747
New Hampshire	212	112	31	11	58	17.6%	563	270	293

Table 1
Spending Reductions under Balanced Budget Amendment, FY 2002 ($mil)

	Cuts in Grants to State Governments					Required State Tax	Cuts in Other Federal Spending		
State	Total	Medicaid	Highway	AFDC	Other	Increase	Total	Medicare	Other
New Jersey	2,476	1,500	141	129	705	12.7%	4,653	2,894	1,759
New Mexico	524	233	70	28	193	12.9%	2,117	321	1,796
New York	8,181	5,442	274	535	1,930	17.4%	11,058	6,876	4,182
North Carolina	1,697	1,025	136	95	441	11.1%	3,217	1,432	1,785
North Dakota	229	105	35	8	81	19.7%	563	231	332
Ohio	2,826	1,718	170	212	727	14.4%	6,007	3,442	2,565
Oklahoma	770	424	51	51	244	12.4%	2,110	934	1,177
Oregon	706	342	54	47	263	12.2%	1,976	833	1,143
Pennsylvania	3,057	1,767	211	178	901	12.7%	8,555	5,120	3,435
Rhode Island	430	255	42	23	109	21.4%	619	347	272
South Carolina	1,003	644	68	31	260	14.3%	2,217	682	1,535
South Dakota	231	103	39	6	82	24.7%	577	205	372
Tennessee	1,537	989	78	60	411	19.5%	3,845	1,349	2,496
Texas	4,167	2,520	340	147	1,159	14.0%	10,758	4,280	6,479
Utah	422	190	49	22	160	11.4%	1,078	235	842
Vermont	207	89	37	13	68	17.4%	301	150	151
Virginia	1,005	490	72	49	393	8.2%	6,073	1,374	4,699
Washington	1,318	730	117	126	346	8.4%	3,569	1,107	2,463
West Virginia	765	488	45	32	199	20.6%	1,209	600	608
Wisconsin	1,250	694	111	96	349	10.3%	2,480	1,503	977
Wyoming	218	55	38	8	118	18.7%	286	96	191
State Total	70,172	40,271	5,093	4,480	20,328	12.6%	172,792	77,199	95,593
Undist. & Terr.	1,127	43	83	28	973	N.A.	3,700	276	3,424

Table 2
Spending Reductions under Contract with America, FY 2002 ($mil)

	Cuts in Grants to State Governments					Required State Tax	Cuts in Other Federal Spending		
State	Total	Medicaid	Highway	AFDC	Other	Increase	Total	Medicare	Other
U.S. Total	97,825	55,312	7,102	6,185	29,226	N.A.	242,151	106,298	135,854
Alabama	1,594	879	135	44	536	22.5%	4,195	1,588	2,608
Alaska	420	123	98	26	174	13.5%	790	60	730
Arizona	1,261	712	108	93	348	14.2%	3,288	1,302	1,986
Arkansas	992	571	90	23	309	22.7%	2,150	1,052	1,098
California	10,576	5,412	607	1,317	3,241	12.6%	27,880	12,486	15,394
Colorado	1,036	531	108	49	347	16.2%	3,793	989	2,804
Connecticut	1,383	805	145	86	348	15.4%	2,529	1,494	1,035
Delaware	217	97	25	12	83	9.8%	526	241	284
DC	956	252	23	32	650	27.9%	6,774	429	6,345
Florida	3,644	2,086	277	233	1,048	14.0%	13,421	7,321	6,100
Georgia	2,206	1,286	180	138	601	16.5%	5,200	1,910	3,290
Hawaii	450	161	85	32	172	9.3%	1,012	296	716
Idaho	349	162	46	11	131	13.6%	1,173	299	874
Illinois	3,534	1,858	239	213	1,224	15.9%	10,334	5,614	4,721
Indiana	2,044	1,312	168	74	490	18.9%	3,473	2,054	1,419
Iowa	864	451	95	48	270	15.0%	2,633	1,231	1,402
Kansas	853	487	71	40	255	17.8%	2,374	1,124	1,249
Kentucky	1,587	947	95	77	468	19.8%	2,896	1,306	1,590
Louisiana	2,697	2,059	129	66	444	38.2%	3,240	1,462	1,778
Maine	621	383	38	33	166	24.0%	983	529	454
Maryland	1,543	798	113	89	543	13.5%	8,579	1,889	6,690
Massachusetts	2,627	1,472	340	185	630	17.3%	6,425	3,360	3,065
Michigan	3,398	1,859	192	314	1,034	18.1%	6,844	4,572	2,271
Minnesota	1,615	931	139	113	431	13.0%	3,494	1,541	1,954
Mississippi	1,185	681	84	33	387	28.5%	2,294	978	1,316
Missouri	1,806	1,025	149	85	547	21.2%	5,408	2,444	2,965
Montana	380	169	71	17	123	27.1%	1,021	298	722
Nebraska	533	264	60	31	177	18.3%	1,665	661	1,004
Nevada	312	159	44	15	94	8.6%	1,379	354	1,025
New Hampshire	291	154	43	16	79	24.1%	773	370	403

Table 2
Spending Reductions under Contract with America, FY 2002 ($mil)

State	Cuts in Grants to State Governments					Required State Tax	Cuts in Other Federal Spending		
	Total	Medicaid	Highway	AFDC	Other	Increase	Total	Medicare	Other
New Jersey	3,397	2,059	194	177	968	17.5%	6,384	3,971	2,413
New Mexico	719	320	96	38	265	17.6%	2,904	440	2,464
New York	11,225	7,466	376	734	2,649	23.8%	15,172	9,435	5,738
North Carolina	2,329	1,406	187	130	605	15.2%	4,414	1,965	2,449
North Dakota	314	144	48	10	111	27.0%	773	317	455
Ohio	3,878	2,358	233	290	997	19.8%	8,242	4,722	3,520
Oklahoma	1,056	582	70	69	335	17.0%	2,896	1,281	1,615
Oregon	969	469	75	65	361	16.8%	2,711	1,143	1,568
Pennsylvania	4,194	2,424	290	244	1,237	17.4%	11,738	7,025	4,713
Rhode Island	590	350	58	32	150	29.3%	849	476	373
South Carolina	1,376	883	94	42	357	19.6%	3,042	935	2,106
South Dakota	316	142	53	9	113	33.8%	792	281	511
Tennessee	2,109	1,357	107	82	563	26.7%	5,275	1,850	3,425
Texas	5,717	3,457	466	202	1,591	19.2%	14,761	5,872	8,889
Utah	579	261	68	31	220	15.6%	1,479	323	1,156
Vermont	284	122	51	18	93	23.9%	413	206	207
Virginia	1,379	673	99	68	539	11.2%	8,332	1,885	6,447
Washington	1,809	1,001	161	172	474	11.5%	4,897	1,518	3,379
West Virginia	1,049	670	62	44	273	28.3%	1,658	824	835
Wisconsin	1,716	952	153	132	479	14.2%	3,402	2,062	1,340
Wyoming	300	75	52	10	162	25.7%	393	131	262
State Total	96,278	55,253	6,988	6,147	27,891	17.3%	237,075	105,919	131,155
Undist. & Terr.	1,547	59	114	38	1,335	N.A.	5,077	378	4,698

Balanced Budget Amendment
Estimation of State-by-State Effects

The following description provides information on the estimation and allocation of spending cuts under two scenarios that achieve a balanced budget by FY2002 without tax increases and with Social Security and defense excluded from spending reductions. The second scenario differs from the first in that it also incorporates a set of deficit-increasing provisions in the Contract with America (CWA). These provisions are all tax reductions except for a spending increase associated with relaxation of the Social Security earnings test. No specific defense spending increases discussed in the CWA are reflected in the simulations.

Step 1: *Derive size of aggregate budget cuts.*

Congressional Budget Office (CBO) baseline estimates of the Federal deficit were taken from Table 4 of the preliminary *Economic and Budget Outlook* dated January 5, 1995. Equal yearly deficit reductions, beginning in FY1996, were then computed which were sufficient to achieve a balanced budget by FY2002.

The required cuts take into account the interest savings that would result from lower deficits and debt; a 6.7 percent rate of interest was assumed throughout based on long-term CBO projections of the 10-year Treasury note rate. The estimates are static in nature and reflect no macroeconomic feedback--e.g., lower economic growth resulting from the contractionary effects of deficit reduction or higher growth resulting from lower tax rates. Deficit-reducing spending and tax changes of $248 billion, or 22.5 percent of noninterest, nondefense, non-Social Security spending, would have to be made in FY2002 to achieve a balanced budget. The required cumulative deficit reduction is approximately $1.3 trillion, of which about $0.2 trillion occurs through interest savings.

A similar procedure was used to derive required spending reductions with the CWA's tax cut and Social Security spending amounts (and associated interest carrying costs) added to the CBO deficit baseline. Estimated revenue effects of the proposed tax reductions were obtained from the Treasury Department, Office of Tax Analysis. Annual costs of the proposed relaxation of the Social Security earnings test were taken from a National Economic Council staff working paper, September 20, 1994. The required percentage spending reduction is 30.9 percent in this scenario. The aggregate required cuts in total spending in FY2002 total $340 billion.

Step 2: *Derive allocation parameters for states.*

Grants to state and local governments, as well as Social Security, defense, and other Federal spending, are reported in *Federal Expenditures by State for Fiscal Year 1993*. Our analysis divides intergovernmental grants into four components: Aid to Families with Dependent Children, Medicaid, highway trust fund grants, and all Other. It was assumed that all grants in the first three of these categories went directly to state governments. To estimate the local share of the Other category, we used estimates of total 1992 intergovernmental revenues from Federal to local governments in each state, as reported in the August 1994 Census publication

Government Finances, 1991-92: Preliminary Report. These state-by-state estimates were divided by the *Government Finances* estimates of Federal revenues to states and localities combined, less the values of AFDC, Medicaid, and highway grants from the FY1992 edition of *Federal Expenditures by State.* It should be emphasized that discrepancies between the *Government Finances* and *Federal Expenditures* aggregates, resulting from different definitions and sources, make this local vs. state decomposition of Other grants an imprecise process.

State tax revenues for the average of the 1990 and 1992 fiscal years was also taken from issues of *Government Finances.* The use of two years at different points in the business cycle was designed to mitigate cyclical influences on projected revenue.

Step 3: *Project FY2002 Grants and State Taxes.*

CBO's projected levels for FY2002 for Social Security, Medicare, and most other major spending categories were taken from the above-mentioned CBO report. For defense spending, the Administration's projection of FY2000 defense outlays was inflated by the annual rate of growth of total discretionary spending from FY2000 to FY2002 in the CBO projections.

The projection of grant amounts was also derived from the long-term CBO budget forecast. AFDC grants were projected using the ratio of 2002 to 1993 values of Other Mandatory spending as reported by CBO, respectively, in the January 5 report and on page 37 of *The Economic and Budget Outlook: Update* dated August 1994. (Unpublished figures on FY1993 Civil Service and military retirement spending were obtained from CBO.) Highway trust fund grants were projected using the ratio of 2002 to 1993 values of domestic discretionary spending; the 2002 value was estimated as estimated total nondefense discretionary spending multiplied by the FY2002 ratio of domestic to the sum of international and domestic discretionary spending in Table 4 of the January 5 report.

The category of Other grants was decomposed into discretionary and mandatory components. The Other mandatory component was defined to include: Agricultural Marketing Service funds for strengthening markets (Section 32); child nutrition programs; food stamp grants; special milk program; national grasslands payments to counties; social services block grants; foster care and adoption assistance; assistance for legalized aliens; other Administration for Children and Families grants; and Supplemental Security Income grants. These were projected in the same manner as AFDC, while the residual Other discretionary grants were projected in the same manner as highway grants.

Total baseline state taxes were projected to move in proportion to nominal U.S. Gross Domestic Product. The projection of GDP for calendar year 2000 was taken from Table 1 of the CBO January 5 report and increased by three years of assumed 2.3 percent real growth and 2.8 percent increases in the GDP price deflator. The growth in nominal GDP between 1991 and 2002 was converted to a per capita basis. Individual state taxes in FY2002 were then estimated by multiplying 1990-1992 average taxes by the product of 1991-2002 state population growth and the growth in U.S. per capita GDP. State population totals for 2000 and 2010 were drawn from the 1994 Statistical Abstract, and our estimates for 2002 were interpolations of the 2000 and 2010 values.

Step 4: Derive required grant reductions and state tax increases.

The percentage reductions in FY2002 grants and other spending components necessary to achieve budget balance were, by assumption, equal to the aggregate percentage rate computed for all nondefense, non-Social Security spending. Finally, the percentage increase in the state tax levels necessary to make up the dollar loss in Federal grants to each state was computed.

Office of Economic Policy, Department of the Treasury, January 11, 1995

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

January 12, 1995

The Honorable Howard Dean, M.D.
Chairman, National Governors' Association
Office of the Governor
Montpelier, VT 05659

Dear Governor Dean:

I write to answer your request for information on the likely effects of passage of a balanced-budget amendment, accompanied by "Contract with America" federal tax reductions, on state budgets and state taxes.

Enclosed is a set of estimates that Treasury staff have constructed of the possible effect on states and their finances of a constitutional amendment requiring the balancing of the federal budget in 2002, accompanied by the tax reductions mentioned above. These estimates are based on the following assumptions: (I) that the federal budget would be balanced through spending cuts, (II) that Social Security and Defense spending would not be reduced below baseline, and thus (III) that the entire burden of balancing the federal budget would be placed on non-interest, non-Social Security, non-Defense spending, as proposed methods for balancing the budget and financing various tax cuts excludes Social Security and Defense.

The estimates assume that every expenditure--interest, Social Security, and Defense aside --would be reduced relative to baseline by the same proportional amount. The estimates assume that the deficit reduction will be phased in gradually, an equal amount in each year between now and 2002. This arrangement of the spending cuts results in substantial interest savings relative to the baseline in 2002, and thus reduces the amount of non-interest spending that must be cut in 2002 to balance the budget.

Nevertheless, the cuts required in 2002 would be severe. To help balance the budget and help offset the tax reductions noted above, federal grants to states would be cut by a total of $97.8 billion in fiscal 2002. Other federal spending that directly benefits state residents would be cut by $242.2 billion in fiscal 2002.

The cuts in grants--in Medicaid, highway funds, AFDC, and other grants--and the cuts in other spending--on Medicare and on other spending--were distributed across states proportionately to current levels of federal expenditures. Also reported is the amount by which total state taxes would have to be raised if the state wished to fully offset the reduction in federal grants.

Grants to states in the aggregate, to specific states, and to states for specific programs may be cut by more or by less than projected here. Yet, without further detail, the most reasonable method for illustrating the likely burdens on states is to assume across-the-board proportional cuts.

Note, also, that these estimates do not incorporate any significant feedback effects: it is possible that shifts in monetary policy would not be able to fully offset the downward macroeconomic impact of a balanced-budget amendment. To the extent that implementation of an amendment slows growth and reduces state revenues, the gap would be somewhat larger and the effect on state finances somewhat more severe. On the other hand, balancing the federal budget could have substantial positive effects on the U.S. economy, which would promise to raise state revenues as state economic activity increased. Such effects are not discussed here.

Note, finally, that this set of estimates is far from being a complete analysis of a balanced-budget amendment. Its principal function is to identify and evaluate the approximate impact on state government finances of a constitutional amendment that requires federal budget balance by 2002.

Sincerely yours,

Joyce Carrier
Deputy Assistant Secretary
for Public Liaison

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF ALABAMA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Alabama state government by $1.2 billion.**

- $641 million per year in lost funding for Medicaid
- $98 million per year in lost highway trust fund grants
- $32 million per year in lost funding for welfare (AFDC)
- $391 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Alabama would have to increase state taxes by 16.4 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Alabama state government by $1.6 billion.**

- $879 million per year in lost funding for Medicaid
- $135 million per year in lost highway trust fund grants
- $44 million per year in lost funding for welfare (AFDC)
- $536 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Alabama would have to increase state taxes by 22.5 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Alabama by $4.2 billion.**

- $1.6 billion per year in Medicare benefits
- $2.6 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF ALASKA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Alaska state government by $306 million.**

- $89 million per year in lost funding for Medicaid
- $71 million per year in lost highway trust fund grants
- $19 million per year in lost funding for welfare (AFDC)
- $127 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Alaska would have to increase state taxes by 9.8 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Alaska state government by $420 million.**

- $123 million per year in lost funding for Medicaid
- $98 million per year in lost highway trust fund grants
- $26 million per year in lost funding for welfare (AFDC)
- $174 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Alaska would have to increase state taxes by 13.5 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Alaska by $790 million.**

- $60 million per year in Medicare benefits
- $730 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF ARIZONA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Arizona state government by $919 million.**

- $519 million per year in lost funding for Medicaid
- $78 million per year in lost highway trust fund grants
- $68 million per year in lost funding for welfare (AFDC)
- $254 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Arizona would have to increase state taxes by 10.4 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Arizona state government by $1.3 billion.**

- $712 million per year in lost funding for Medicaid
- $108 million per year in lost highway trust fund grants
- $93 million per year in lost funding for welfare (AFDC)
- $348 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Arizona would have to increase state taxes by 14.2 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Arizona by $3.3 billion.**

- $1.3 billion per year in Medicare benefits
- $2.0 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF ARKANSAS[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Arkansas state government by $723 million.**

- $416 million per year in lost funding for Medicaid
- $65 million per year in lost highway trust fund grants
- $16 million per year in lost funding for welfare (AFDC)
- $225 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Arkansas would have to increase state taxes by 16.5 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Arkansas state government by $992 million.**

- $571 million per year in lost funding for Medicaid
- $90 million per year in lost highway trust fund grants
- $23 million per year in lost funding for welfare (AFDC)
- $309 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Arkansas would have to increase state taxes by 22.7 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Arkansas by $2.1 billion.**

- $1.1 billion per year in Medicare benefits
- $1.1 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF CALIFORNIA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the California state government by $7.7 billion.

- $3.9 billion per year in lost funding for Medicaid
- $442 million per year in lost highway trust fund grants
- $960 million per year in lost funding for welfare (AFDC)
- $2.4 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *California would have to increase state taxes by 9.2 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the California state government by $10.6 billion.

- $5.4 billion per year in lost funding for Medicaid
- $607 million per year in lost highway trust fund grants
- $1.3 billion per year in lost funding for welfare (AFDC)
- $3.2 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *California would have to increase state taxes by 12.6 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in California by $27.9 billion.

- $12.5 billion per year in Medicare benefits
- $15.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF COLORADO[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Colorado state government by $755 million.

- $387 million per year in lost funding for Medicaid
- $79 million per year in lost highway trust fund grants
- $36 million per year in lost funding for welfare (AFDC)
- $253 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Colorado would have to increase state taxes by 11.8 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Colorado state government by $1.0 billion.

- $531 million per year in lost funding for Medicaid
- $108 million per year in lost highway trust fund grants
- $49 million per year in lost funding for welfare (AFDC)
- $347 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Colorado would have to increase state taxes by 16.2 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Colorado by $3.8 billion.

- $989 million per year in Medicare benefits
- $2.8 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF CONNECTICUT[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Connecticut state government by $1.0 billion.**

- $587 million per year in lost funding for Medicaid
- $105 million per year in lost highway trust fund grants
- $63 million per year in lost funding for welfare (AFDC)
- $253 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Connecticut would have to increase state taxes by 11.2 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Connecticut state government by $1.4 billion.**

- $805 million per year in lost funding for Medicaid
- $145 million per year in lost highway trust fund grants
- $86 million per year in lost funding for welfare (AFDC)
- $348 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Connecticut would have to increase state taxes by 15.4 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Connecticut by $2.5 billion.**

- $1.5 billion per year in Medicare benefits
- $1.0 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF DELAWARE[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Delaware state government by $158 million.

- $70 million per year in lost funding for Medicaid
- $18 million per year in lost highway trust fund grants
- $9 million per year in lost funding for welfare (AFDC)
- $61 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Delaware would have to increase state taxes by 7.2 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Delaware state government by $217 million.

- $97 million per year in lost funding for Medicaid
- $25 million per year in lost highway trust fund grants
- $12 million per year in lost funding for welfare (AFDC)
- $83 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Delaware would have to increase state taxes by 9.8 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Delaware by $526 million.

- $241 million per year in Medicare benefits
- $284 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE DISTRICT OF COLUMBIA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the D.C. government by $697 million.

- $183 million per year in lost funding for Medicaid
- $17 million per year in lost highway trust fund grants
- $24 million per year in lost funding for welfare (AFDC)
- $473 million per year in lost funding for education, job training, the environment, housing, and other areas
- *D.C. would have to increase state taxes by 20.4 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the D.C. government by $956 million.

- $252 million per year in lost funding for Medicaid
- $23 million per year in lost highway trust fund grants
- $32 million per year in lost funding for welfare (AFDC)
- $650 million per year in lost funding for education, job training, the environment, housing, and other areas
- *D.C. would have to increase state taxes by 27.9 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in DC by $6.8 billion.

- $429 million per year in Medicare benefits
- $6.3 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF FLORIDA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Florida state government by $2.7 billion.**

- $1.5 billion per year in lost funding for Medicaid
- $202 million per year in lost highway trust fund grants
- $170 million per year in lost funding for welfare (AFDC)
- $764 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Florida would have to increase state taxes by 10.2 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Florida state government by $3.6 billion.**

- $2.1 billion per year in lost funding for Medicaid
- $277 million per year in lost highway trust fund grants
- $233 million per year in lost funding for welfare (AFDC)
- $1.0 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *Florida would have to increase state taxes by 14.0 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Florida by $13.4 billion.**

- $7.3 billion per year in Medicare benefits
- $6.1 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF GEORGIA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Georgia state government by $1.6 billion.**

- $938 million per year in lost funding for Medicaid
- $131 million per year in lost highway trust fund grants
- $101 million per year in lost funding for welfare (AFDC)
- $438 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Georgia would have to increase state taxes by 12.0 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Georgia state government by $2.2 billion.**

- $1.3 billion per year in lost funding for Medicaid
- $180 million per year in lost highway trust fund grants
- $138 million per year in lost funding for welfare (AFDC)
- $601 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Georgia would have to increase state taxes by 16.5 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Georgia by $5.2 billion.**

- $1.9 billion per year in Medicare benefits
- $3.3 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF HAWAII[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Hawaii state government by $328 million.**

- $117 million per year in lost funding for Medicaid
- $62 million per year in lost highway trust fund grants
- $24 million per year in lost funding for welfare (AFDC)
- $125 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Hawaii would have to increase state taxes by 6.8 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Hawaii state government by $450 million.**

- $161 million per year in lost funding for Medicaid
- $85 million per year in lost highway trust fund grants
- $32 million per year in lost funding for welfare (AFDC)
- $172 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Hawaii would have to increase state taxes by 9.3 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Hawaii by $1.0 billion.**

- $296 million per year in Medicare benefits
- $716 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF IDAHO[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Idaho state government by $254 million.

- $118 million per year in lost funding for Medicaid
- $33 million per year in lost highway trust fund grants
- $8 million per year in lost funding for welfare (AFDC)
- $95 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Idaho would have to increase state taxes by 9.9 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Idaho state government by $349 million.

- $162 million per year in lost funding for Medicaid
- $46 million per year in lost highway trust fund grants
- $11 million per year in lost funding for welfare (AFDC)
- $131 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Idaho would have to increase state taxes by 13.6 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Idaho by $1.2 billion.

- $299 million per year in Medicare benefits
- $874 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF ILLINOIS[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Illinois state government by \$2.6 billion.

- \$1.4 billion per year in lost funding for Medicaid
- \$174 million per year in lost highway trust fund grants
- \$155 million per year in lost funding for welfare (AFDC)
- \$892 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Illinois would have to increase state taxes by 11.6 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Illinois state government by \$3.5 billion.

- \$1.9 billion per year in lost funding for Medicaid
- \$239 million per year in lost highway trust fund grants
- \$213 million per year in lost funding for welfare (AFDC)
- \$1.2 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *Illinois would have to increase state taxes by 15.9 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Illinois by \$10.3 billion.

- \$5.6 billion per year in Medicare benefits
- \$4.7 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF INDIANA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Indiana state government by $1.5 billion.

- $956 million per year in lost funding for Medicaid
- $123 million per year in lost highway trust fund grants
- $54 million per year in lost funding for welfare (AFDC)
- $357 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Indiana would have to increase state taxes by 13.8 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Indiana state government by $2.0 billion.

- $1.3 billion per year in lost funding for Medicaid
- $168 million per year in lost highway trust fund grants
- $74 million per year in lost funding for welfare (AFDC)
- $490 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Indiana would have to increase state taxes by 18.9 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Indiana by $3.5 billion.

- $2.1 billion per year in Medicare benefits
- $1.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF IOWA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Iowa state government by $630 million.**

- $328 million per year in lost funding for Medicaid
- $69 million per year in lost highway trust fund grants
- $35 million per year in lost funding for welfare (AFDC)
- $197 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Iowa would have to increase state taxes by 10.9 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Iowa state government by $864 million.**

- $451 million per year in lost funding for Medicaid
- $95 million per year in lost highway trust fund grants
- $48 million per year in lost funding for welfare (AFDC)
- $270 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Iowa would have to increase state taxes by 15.0 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Iowa by $2.6 billion.**

- $1.2 billion per year in Medicare benefits
- $1.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF KANSAS[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Kansas state government by $622 million.**

- $355 million per year in lost funding for Medicaid
- $52 million per year in lost highway trust fund grants
- $29 million per year in lost funding for welfare (AFDC)
- $186 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Kansas would have to increase state taxes by 13.0 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Kansas state government by $853 million.**

- $487 million per year in lost funding for Medicaid
- $71 million per year in lost highway trust fund grants
- $40 million per year in lost funding for welfare (AFDC)
- $255 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Kansas would have to increase state taxes by 17.8 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Kansas by $2.4 billion.**

- $1.1 billion per year in Medicare benefits
- $1.2 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF KENTUCKY[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Kentucky state government by $1.2 billion.**

- $690 million per year in lost funding for Medicaid
- $69 million per year in lost highway trust fund grants
- $56 million per year in lost funding for welfare (AFDC)
- $341 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Kentucky would have to increase state taxes by 14.5 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Kentucky state government by $1.6 billion.**

- $947 million per year in lost funding for Medicaid
- $95 million per year in lost highway trust fund grants
- $77 million per year in lost funding for welfare (AFDC)
- $468 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Kentucky would have to increase state taxes by 19.8 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Kentucky by $2.9 billion.**

- $1.3 billion per year in Medicare benefits
- $1.6 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF LOUISIANA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Louisiana state government by $2.0 billion.

- $1.5 billion per year in lost funding for Medicaid
- $94 million per year in lost highway trust fund grants
- $48 million per year in lost funding for welfare (AFDC)
- $324 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Louisiana would have to increase state taxes by 27.8 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Louisiana state government by $2.7 billion.

- $2.1 billion per year in lost funding for Medicaid
- $129 million per year in lost highway trust fund grants
- $66 million per year in lost funding for welfare (AFDC)
- $444 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Louisiana would have to increase state taxes by 38.2 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Louisiana by $3.2 billion.

- $1.5 billion per year in Medicare benefits
- $1.8 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MAINE[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Maine state government by $452 million.

- $279 million per year in lost funding for Medicaid
- $28 million per year in lost highway trust fund grants
- $24 million per year in lost funding for welfare (AFDC)
- $121 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Maine would have to increase state taxes by 17.5 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Maine state government by $621 million.

- $383 million per year in lost funding for Medicaid
- $38 million per year in lost highway trust fund grants
- $33 million per year in lost funding for welfare (AFDC)
- $166 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Maine would have to increase state taxes by 24.0 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Maine by $983 million.

- $529 million per year in Medicare benefits
- $454 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MARYLAND[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Maryland state government by $1.1 billion.**

- $581 million per year in lost funding for Medicaid
- $83 million per year in lost highway trust fund grants
- $65 million per year in lost funding for welfare (AFDC)
- $396 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Maryland would have to increase state taxes by 9.9 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Maryland state government by $1.5 billion.**

- $798 million per year in lost funding for Medicaid
- $113 million per year in lost highway trust fund grants
- $89 million per year in lost funding for welfare (AFDC)
- $543 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Maryland would have to increase state taxes by 13.5 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Maryland by $8.6 billion.**

- $1.9 billion per year in Medicare benefits
- $6.7 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MASSACHUSETTS[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Massachusetts state government by $1.9 billion.

- $1.1 billion per year in lost funding for Medicaid
- $248 million per year in lost highway trust fund grants
- $135 million per year in lost funding for welfare (AFDC)
- $459 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Massachusetts would have to increase state taxes by 12.6 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Massachusetts state government by $2.6 billion.

- $1.5 billion per year in lost funding for Medicaid
- $340 million per year in lost highway trust fund grants
- $185 million per year in lost funding for welfare (AFDC)
- $630 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Massachusetts would have to increase state taxes by 17.3 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Massachusetts by $6.4 billion.

- $3.4 billion per year in Medicare benefits
- $3.1 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MICHIGAN[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Michigan state government by $2.5 billion.

- $1.4 billion per year in lost funding for Medicaid
- $140 million per year in lost highway trust fund grants
- $229 million per year in lost funding for welfare (AFDC)
- $753 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Michigan would have to increase state taxes by 13.2 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Michigan state government by $3.4 billion.

- $1.9 billion per year in lost funding for Medicaid
- $192 million per year in lost highway trust fund grants
- $314 million per year in lost funding for welfare (AFDC)
- $1.0 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *Michigan would have to increase state taxes by 18.1 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Michigan by $6.8 billion.

- $4.6 billion per year in Medicare benefits
- $2.3 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MINNESOTA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Minnesota state government by $1.2 billion.

- $679 million per year in lost funding for Medicaid
- $102 million per year in lost highway trust fund grants
- $83 million per year in lost funding for welfare (AFDC)
- $314 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Minnesota would have to increase state taxes by 9.4 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Minnesota state government by $1.6 billion.

- $931 million per year in lost funding for Medicaid
- $139 million per year in lost highway trust fund grants
- $113 million per year in lost funding for welfare (AFDC)
- $431 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Minnesota would have to increase state taxes by 13.0 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Minnesota by $3.5 billion.

- $1.5 billion per year in Medicare benefits
- $2.0 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MISSISSIPPI[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Mississippi state government by $864 million.**

- $496 million per year in lost funding for Medicaid
- $61 million per year in lost highway trust fund grants
- $24 million per year in lost funding for welfare (AFDC)
- $282 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Mississippi would have to increase state taxes by 20.8 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Mississippi state government by $1.2 billion.**

- $681 million per year in lost funding for Medicaid
- $84 million per year in lost highway trust fund grants
- $33 million per year in lost funding for welfare (AFDC)
- $387 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Mississippi would have to increase state taxes by 28.5 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Mississippi by $2.3 billion.**

- $978 million per year in Medicare benefits
- $1.3 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MISSOURI[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Missouri state government by $1.3 billion.

- $747 million per year in lost funding for Medicaid
- $109 million per year in lost highway trust fund grants
- $62 million per year in lost funding for welfare (AFDC)
- $398 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Missouri would have to increase state taxes by 15.5 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Missouri state government by $1.8 billion.

- $1.0 billion per year in lost funding for Medicaid
- $149 million per year in lost highway trust fund grants
- $85 million per year in lost funding for welfare (AFDC)
- $547 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Missouri would have to increase state taxes by 21.2 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Missouri by $5.4 billion.

- $2.4 billion per year in Medicare benefits
- $3.0 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF MONTANA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Montana state government by $277 million.**

- $123 million per year in lost funding for Medicaid
- $52 million per year in lost highway trust fund grants
- $12 million per year in lost funding for welfare (AFDC)
- $89 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Montana would have to increase state taxes by 19.8 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Montana state government by $380 million.**

- $169 million per year in lost funding for Medicaid
- $71 million per year in lost highway trust fund grants
- $17 million per year in lost funding for welfare (AFDC)
- $123 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Montana would have to increase state taxes by 27.1 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Montana by $1.0 billion.**

- $298 million per year in Medicare benefits
- $722 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NEBRASKA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Nebraska state government by $388 million.**

- $192 million per year in lost funding for Medicaid
- $44 million per year in lost highway trust fund grants
- $23 million per year in lost funding for welfare (AFDC)
- $129 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Nebraska would have to increase state taxes by 13.3 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Nebraska state government by $533 million.**

- $264 million per year in lost funding for Medicaid
- $60 million per year in lost highway trust fund grants
- $31 million per year in lost funding for welfare (AFDC)
- $177 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Nebraska would have to increase state taxes by 18.3 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Nebraska by $1.7 billion.**

- $661 million per year in Medicare benefits
- $1.0 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NEVADA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Nevada state government by $227 million.

- $116 million per year in lost funding for Medicaid
- $32 million per year in lost highway trust fund grants
- $11 million per year in lost funding for welfare (AFDC)
- $68 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Nevada would have to increase state taxes by 6.2 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Nevada state government by $312 million.

- $159 million per year in lost funding for Medicaid
- $44 million per year in lost highway trust fund grants
- $15 million per year in lost funding for welfare (AFDC)
- $94 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Nevada would have to increase state taxes by 8.6 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Nevada by $1.4 billion.

- $354 million per year in Medicare benefits
- $1.0 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NEW HAMPSHIRE[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the New Hampshire state government by $212 million.**

- $112 million per year in lost funding for Medicaid
- $31 million per year in lost highway trust fund grants
- $11 million per year in lost funding for welfare (AFDC)
- $58 million per year in lost funding for education, job training, the environment, housing, and other areas
- *New Hampshire would have to increase state taxes by 17.6 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the New Hampshire state government by $291 million.**

- $154 million per year in lost funding for Medicaid
- $43 million per year in lost highway trust fund grants
- $16 million per year in lost funding for welfare (AFDC)
- $79 million per year in lost funding for education, job training, the environment, housing, and other areas
- *New Hampshire would have to increase state taxes by 24.1 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in New Hampshire by $773 million.**

- $370 million per year in Medicare benefits
- $403 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NEW JERSEY[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the New Jersey state government by $2.5 billion.

- $1.5 billion per year in lost funding for Medicaid
- $141 million per year in lost highway trust fund grants
- $129 million per year in lost funding for welfare (AFDC)
- $705 million per year in lost funding for education, job training, the environment, housing, and other areas
- *New Jersey would have to increase state taxes by 12.7 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the New Jersey state government by $3.4 billion.

- $2.1 billion per year in lost funding for Medicaid
- $194 million per year in lost highway trust fund grants
- $177 million per year in lost funding for welfare (AFDC)
- $968 million per year in lost funding for education, job training, the environment, housing, and other areas
- *New Jersey would have to increase state taxes by 17.5 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in New Jersey by $6.4 billion.

- $4.0 billion per year in Medicare benefits
- $2.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NEW MEXICO[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the New Mexico state government by $524 million.**

- $233 million per year in lost funding for Medicaid
- $70 million per year in lost highway trust fund grants
- $28 million per year in lost funding for welfare (AFDC)
- $193 million per year in lost funding for education, job training, the environment, housing, and other areas
- *New Mexico would have to increase state taxes by 12.9 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the New Mexico state government by $719 million.**

- $320 million per year in lost funding for Medicaid
- $96 million per year in lost highway trust fund grants
- $38 million per year in lost funding for welfare (AFDC)
- $265 million per year in lost funding for education, job training, the environment, housing, and other areas
- *New Mexico would have to increase state taxes by 17.6 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in New Mexico by $2.9 billion.**

- $440 million per year in Medicare benefits
- $2.5 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NEW YORK[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the New York state government by $8.2 billion.

- $5.4 billion per year in lost funding for Medicaid
- $274 million per year in lost highway trust fund grants
- $535 million per year in lost funding for welfare (AFDC)
- $1.9 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *New York would have to increase state taxes by 17.4 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the New York state government by $11.2 billion.

- $7.5 billion per year in lost funding for Medicaid
- $376 million per year in lost highway trust fund grants
- $734 million per year in lost funding for welfare (AFDC)
- $2.6 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *New York would have to increase state taxes by 23.8 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in New York by $15.2 billion.

- $9.4 billion per year in Medicare benefits
- $5.7 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NORTH CAROLINA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the North Carolina state government by $1.7 billion.**

- $1.0 billion per year in lost funding for Medicaid
- $136 million per year in lost highway trust fund grants
- $95 million per year in lost funding for welfare (AFDC)
- $441 million per year in lost funding for education, job training, the environment, housing, and other areas
- *North Carolina would have to increase state taxes by 11.1 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the North Carolina state government by $2.3 billion.**

- $1.4 billion per year in lost funding for Medicaid
- $187 million per year in lost highway trust fund grants
- $130 million per year in lost funding for welfare (AFDC)
- $605 million per year in lost funding for education, job training, the environment, housing, and other areas
- *North Carolina would have to increase state taxes by 15.2 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in North Carolina by $4.4 billion.**

- $2.0 billion per year in Medicare benefits
- $2.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF NORTH DAKOTA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the North Dakota state government by $229 million.**

- $105 million per year in lost funding for Medicaid
- $35 million per year in lost highway trust fund grants
- $8 million per year in lost funding for welfare (AFDC)
- $81 million per year in lost funding for education, job training, the environment, housing, and other areas
- *North Dakota would have to increase state taxes by 19.7 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the North Dakota state government by $314 million.**

- $144 million per year in lost funding for Medicaid
- $48 million per year in lost highway trust fund grants
- $10 million per year in lost funding for welfare (AFDC)
- $111 million per year in lost funding for education, job training, the environment, housing, and other areas
- *North Dakota would have to increase state taxes by 27.0 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in North Dakota by $773 million.**

- $317 million per year in Medicare benefits
- $455 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF OHIO[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Ohio state government by $2.8 billion.

- $1.7 billion per year in lost funding for Medicaid
- $170 million per year in lost highway trust fund grants
- $212 million per year in lost funding for welfare (AFDC)
- $727 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Ohio would have to increase state taxes by 14.4 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Ohio state government by $3.9 billion.

- $2.4 billion per year in lost funding for Medicaid
- $233 million per year in lost highway trust fund grants
- $290 million per year in lost funding for welfare (AFDC)
- $997 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Ohio would have to increase state taxes by 19.8 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Ohio by $8.2 billion.

- $4.7 billion per year in Medicare benefits
- $3.5 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF OKLAHOMA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Oklahoma state government by $770 million.**

- $424 million per year in lost funding for Medicaid
- $51 million per year in lost highway trust fund grants
- $51 million per year in lost funding for welfare (AFDC)
- $244 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Oklahoma would have to increase state taxes by 12.4 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Oklahoma state government by $1.1 billion.**

- $582 million per year in lost funding for Medicaid
- $70 million per year in lost highway trust fund grants
- $69 million per year in lost funding for welfare (AFDC)
- $335 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Oklahoma would have to increase state taxes by 17.0 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Oklahoma by $2.9 billion.**

- $1.3 billion per year in Medicare benefits
- $1.6 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF OREGON[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Oregon state government by $706 million.

- $342 million per year in lost funding for Medicaid
- $54 million per year in lost highway trust fund grants
- $47 million per year in lost funding for welfare (AFDC)
- $263 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Oregon would have to increase state taxes by 12.2 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Oregon state government by $969 million.

- $469 million per year in lost funding for Medicaid
- $75 million per year in lost highway trust fund grants
- $65 million per year in lost funding for welfare (AFDC)
- $361 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Oregon would have to increase state taxes by 16.8 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Oregon by $2.7 billion.

- $1.1 billion per year in Medicare benefits
- $1.6 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF PENNSYLVANIA[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Pennsylvania state government by $3.1 billion.

- $1.8 billion per year in lost funding for Medicaid
- $211 million per year in lost highway trust fund grants
- $178 million per year in lost funding for welfare (AFDC)
- $901 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Pennsylvania would have to increase state taxes by 12.7 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Pennsylvania state government by $4.2 billion.

- $2.4 billion per year in lost funding for Medicaid
- $290 million per year in lost highway trust fund grants
- $244 million per year in lost funding for welfare (AFDC)
- $1.2 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *Pennsylvania would have to increase state taxes by 17.4 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Pennsylvania by $11.7 billion.

- $7.0 billion per year in Medicare benefits
- $4.7 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF RHODE ISLAND[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Rhode Island state government by $430 million.**

- $255 million per year in lost funding for Medicaid
- $42 million per year in lost highway trust fund grants
- $23 million per year in lost funding for welfare (AFDC)
- $109 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Rhode Island would have to increase state taxes by 21.4 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Rhode Island state government by $590 million.**

- $350 million per year in lost funding for Medicaid
- $58 million per year in lost highway trust fund grants
- $32 million per year in lost funding for welfare (AFDC)
- $150 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Rhode Island would have to increase state taxes by 29.3 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Rhode Island by $849 million.**

- $476 million per year in Medicare benefits
- $373 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF SOUTH CAROLINA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the South Carolina state government by $1.0 billion.**

- $644 million per year in lost funding for Medicaid
- $68 million per year in lost highway trust fund grants
- $31 million per year in lost funding for welfare (AFDC)
- $260 million per year in lost funding for education, job training, the environment, housing, and other areas
- *South Carolina would have to increase state taxes by 14.3 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the South Carolina state government by $1.4 billion.**

- $883 million per year in lost funding for Medicaid
- $94 million per year in lost highway trust fund grants
- $42 million per year in lost funding for welfare (AFDC)
- $357 million per year in lost funding for education, job training, the environment, housing, and other areas
- *South Carolina would have to increase state taxes by 19.6 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in South Carolina by $3.0 billion.**

- $935 million per year in Medicare benefits
- $2.1 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF SOUTH DAKOTA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the South Dakota state government by $231 million.**

- $103 million per year in lost funding for Medicaid
- $39 million per year in lost highway trust fund grants
- $6 million per year in lost funding for welfare (AFDC)
- $82 million per year in lost funding for education, job training, the environment, housing, and other areas
- *South Dakota would have to increase state taxes by 24.7 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the South Dakota state government by $316 million.**

- $142 million per year in lost funding for Medicaid
- $53 million per year in lost highway trust fund grants
- $9 million per year in lost funding for welfare (AFDC)
- $113 million per year in lost funding for education, job training, the environment, housing, and other areas
- *South Dakota would have to increase state taxes by 33.8 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in South Dakota by $792 million.**

- $281 million per year in Medicare benefits
- $511 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF TENNESSEE[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Tennessee state government by $1.5 billion.**

- $989 million per year in lost funding for Medicaid
- $78 million per year in lost highway trust fund grants
- $60 million per year in lost funding for welfare (AFDC)
- $411 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Tennessee would have to increase state taxes by 19.5 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Tennessee state government by $2.1 billion.**

- $1.4 billion per year in lost funding for Medicaid
- $107 million per year in lost highway trust fund grants
- $82 million per year in lost funding for welfare (AFDC)
- $563 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Tennessee would have to increase state taxes by 26.7 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Tennessee by $5.3 billion.**

- $1.9 billion per year in Medicare benefits
- $3.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF TEXAS[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Texas state government by $4.2 billion.

- $2.5 billion per year in lost funding for Medicaid
- $340 million per year in lost highway trust fund grants
- $147 million per year in lost funding for welfare (AFDC)
- $1.2 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *Texas would have to increase state taxes by 14.0 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Texas state government by $5.7 billion.

- $3.5 billion per year in lost funding for Medicaid
- $466 million per year in lost highway trust fund grants
- $202 million per year in lost funding for welfare (AFDC)
- $1.6 billion per year in lost funding for education, job training, the environment, housing, and other areas
- *Texas would have to increase state taxes by 19.2 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Texas by $14.8 billion.

- $5.9 billion per year in Medicare benefits
- $8.9 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF UTAH[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Utah state government by $422 million.**

- $190 million per year in lost funding for Medicaid
- $49 million per year in lost highway trust fund grants
- $22 million per year in lost funding for welfare (AFDC)
- $160 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Utah would have to increase state taxes by 11.4 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Utah state government by $579 million.**

- $261 million per year in lost funding for Medicaid
- $68 million per year in lost highway trust fund grants
- $31 million per year in lost funding for welfare (AFDC)
- $220 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Utah would have to increase state taxes by 15.6 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Utah by $1.5 billion.**

- $323 million per year in Medicare benefits
- $1.2 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF VERMONT[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Vermont state government by $207 million.

- $89 million per year in lost funding for Medicaid
- $37 million per year in lost highway trust fund grants
- $13 million per year in lost funding for welfare (AFDC)
- $68 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Vermont would have to increase state taxes by 17.4 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Vermont state government by $284 million.

- $122 million per year in lost funding for Medicaid
- $51 million per year in lost highway trust fund grants
- $18 million per year in lost funding for welfare (AFDC)
- $93 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Vermont would have to increase state taxes by 23.9 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Vermont by $413 million.

- $206 million per year in Medicare benefits
- $207 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF VIRGINIA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Virginia state government by $1.0 billion.**

- $490 million per year in lost funding for Medicaid
- $72 million per year in lost highway trust fund grants
- $49 million per year in lost funding for welfare (AFDC)
- $393 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Virginia would have to increase state taxes by 8.2 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Virginia state government by $1.4 billion.**

- $673 million per year in lost funding for Medicaid
- $99 million per year in lost highway trust fund grants
- $68 million per year in lost funding for welfare (AFDC)
- $539 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Virginia would have to increase state taxes by 11.2 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Virginia by $8.3 billion.**

- $1.9 billion per year in Medicare benefits
- $6.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF WASHINGTON[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the Washington state government by $1.3 billion.**

- $730 million per year in lost funding for Medicaid
- $117 million per year in lost highway trust fund grants
- $126 million per year in lost funding for welfare (AFDC)
- $346 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Washington would have to increase state taxes by 8.4 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Washington state government by $1.8 billion.**

- $1.0 billion per year in lost funding for Medicaid
- $161 million per year in lost highway trust fund grants
- $172 million per year in lost funding for welfare (AFDC)
- $474 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Washington would have to increase state taxes by 11.5 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Washington by $4.9 billion.**

- $1.5 billion per year in Medicare benefits
- $3.4 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF WEST VIRGINIA[1]

I. **A Balanced Budget Amendment would reduce annual Federal grants to the West Virginia state government by $765 million.**

- $488 million per year in lost funding for Medicaid
- $45 million per year in lost highway trust fund grants
- $32 million per year in lost funding for welfare (AFDC)
- $199 million per year in lost funding for education, job training, the environment, housing, and other areas
- *West Virginia would have to increase state taxes by 20.6 percent across-the-board to make up for the loss in grants.*

II. **A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the West Virginia state government by $1.0 billion.**

- $670 million per year in lost funding for Medicaid
- $62 million per year in lost highway trust fund grants
- $44 million per year in lost funding for welfare (AFDC)
- $273 million per year in lost funding for education, job training, the environment, housing, and other areas
- *West Virginia would have to increase state taxes by 28.3 percent across-the-board to make up for the loss in grants.*

III. **A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in West Virginia by $1.7 billion.**

- $824 million per year in Medicare benefits
- $835 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF WISCONSIN[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Wisconsin state government by $1.3 billion.

- $694 million per year in lost funding for Medicaid
- $111 million per year in lost highway trust fund grants
- $96 million per year in lost funding for welfare (AFDC)
- $349 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Wisconsin would have to increase state taxes by 10.3 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Wisconsin state government by $1.7 billion.

- $952 million per year in lost funding for Medicaid
- $153 million per year in lost highway trust fund grants
- $132 million per year in lost funding for welfare (AFDC)
- $479 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Wisconsin would have to increase state taxes by 14.2 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Wisconsin by $3.4 billion.

- $2.1 billion per year in Medicare benefits
- $1.3 billion per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

THE IMPACT OF A BALANCED BUDGET AMENDMENT AND THE CONTRACT WITH AMERICA ON THE STATE OF WYOMING[1]

I. A Balanced Budget Amendment would reduce annual Federal grants to the Wyoming state government by $218 million.

- $55 million per year in lost funding for Medicaid
- $38 million per year in lost highway trust fund grants
- $8 million per year in lost funding for welfare (AFDC)
- $118 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Wyoming would have to increase state taxes by 18.7 percent across-the-board to make up for the loss in grants.*

II. A Balanced Budget Amendment combined with the "Contract with America" tax cuts would require even deeper spending cuts, thereby reducing annual Federal grants to the Wyoming state government by $300 million.

- $75 million per year in lost funding for Medicaid
- $52 million per year in lost highway trust fund grants
- $10 million per year in lost funding for welfare (AFDC)
- $162 million per year in lost funding for education, job training, the environment, housing, and other areas
- *Wyoming would have to increase state taxes by 25.7 percent across-the-board to make up for the loss in grants.*

III. A Balanced Budget Amendment and the "Contract with America" tax cuts would reduce other annual Federal spending in Wyoming by $393 million.

- $131 million per year in Medicare benefits
- $262 million per year in other spending including housing assistance, student loans, veterans' benefits, and grants to local governments

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[1]For all calculations, a balanced budget is achieved by FY 2002 through across-the-board spending cuts that exclude defense and social security.

Chairman ARCHER. Thank you, Governor Dean.

We have listened very carefully to your input, both of you, and we want to reach out and form a better working partnership with you because it is in the best interests of the American people, the Federal Government, and State governments.

All of us appreciate the fact that the landscape is very different today in this country than it was 4, 5, 10 or 20 years ago. I happen to believe that one of the reasons so many Federal programs emerged was because we had unlimited borrowing capacity and it was much easier to come to Washington than to go to a State Governor where 42 of the States have to live under a mandated balanced budget concept. They had to dramatically, in a tough way, cut spending or raise taxes. It is always easier to borrow and to postpone it, and put the load on our children and the next generation.

Whether or not we pass a constitutional amendment to mandate a balanced budget, which I happen to support as a discipline for all society, there will be some form of discipline and constraint that pushes the Federal Government into a lesser borrowing entity. As we move toward reducing our deficits, so the landscape must change for all of us and we must reevaluate what is the appropriate role of government, not just between the Federal Government and State government, but what is the appropriate role of government at any level compared to the private sector. We need to focus on how can we create a better country with opportunity and caring for all Americans and whether it is better done by the private sector or by government.

I will give you an anecdotal example. We all care about the homeless. They reach out and grab our hearts regardless of where we are. But what is the most efficient way to take care of that problem?

In Houston, Tex., there is a hostelry that takes care of homeless people, 250 a day. It does it with no government funds at any level of government, and it does it at a cost of $2.50 a day. It provides hot food, clothing, clean bedding, medical care, and job counseling. Over 50 percent of the people work but they don't have any place to live so they come back to stay there at night. The cheapest Federal program is $40 to $50 per day per person.

Now, we can talk about caring for people, but in the end, we must seek the most efficient way in our society to do it and that is what we hope to be able to do from our level. It is one reason that we think you can be more efficient than we are. We also believe that where the private sector can do it will be even more efficient than you can do it. So we hope to make this a partnership where we can embrace each other and find new ways to reach out to our problems and restore federalism as the bulwark and foundationpiece for the United States of America. I hope we can establish a greater working bond between you and us and then, between you and the private sector in your States. We can truly move this country ahead in a way that will benefit to the greatest degree all Americans.

Now, I recognize my friend and colleague, the ranking Democrat on the committee, for inquiry.

Mr. Gibbons.

Mr. GIBBONS. Thank you, Mr. Archer.

Governor Pataki, Governor Dean. I want to address my remarks to you, Governor Dean, because I recognize that you have had a distinguished career as being Governor and had a lot of experience under your belt and the National Governors' Association has seen fit to elect you as their chairman. I know that is quite an honor and quite a responsibility and I imagine quite a headache sometimes, too.

I think as I listened to this debate, one of the messages that came through, one of the big votes that we are going to have here in this committee is whether we cut the aid to families with dependent children program, a program that is 55, 60 years old and with time has stretched through our society.

There has always been an individual entitlement money made available based upon the entitlement of the children in that program. There are some on this committee and in this Congress who want to cut off that entitlement and work through the appropriations or some other way. Based upon your experience as Governor of a State, do you feel that the State of Vermont with you as Governor would welcome the destruction of that entitlement bond that has been so long a basic part of the aid to families with dependent children program?

Governor DEAN. I thank you for the question. It is a tough issue and I have thought about it a lot, because I did not have a position when I was first confronted with this notion.

The problem is, how do you reform welfare and reintroduce the ethical value of work to families without hurting children? I believe that welfare reform, in fact our welfare reform, does not save money. We have had to increase a relatively small amount in order to pay for training and so forth, but I believe in the value of work so firmly that I was willing to spend more money to make sure that everybody who could work did work.

And interestingly enough, the person who tells the best story I ever heard about it is the President of the United States when he was working on a welfare reform program in Arkansas, went to a school and said—explained his welfare program. And the teacher turned to one of the kids and said, well, what does welfare reform mean to you? And he said, welfare reform means to me, teacher, that when somebody asks me what my mother does, I say she works in the library not she is on welfare.

That changes the whole dynamic of what kids think about parents and what kids think about themselves and what parents think about themselves and that is why I think we have to reform the welfare system. I don't think—I am not in it to save money. I understand we have a deficit problem. I am not sure it can be done right without really hurting children.

We looked—when we did our welfare reform proposal, we looked at cutting off benefits, whack, after 2, 2½ years, just bang, out in the street. The problem is, what do you do with irresponsible parents or parents who for whatever reason don't get into the work force. First thing, suppose you have a recession and working people are out of their jobs for a long time and this Congress had to extend unemployment benefits during the last one. The worst.

The first thing, make sure everybody has employment, otherwise you are essentially cutting people off a public support system who for a long time have been crippled by the system and made to be dependent and putting them in a rowboat and sending them out on the lake with no way of getting around. So if we are going to make people work, which I strongly believe we have to do, we have got to do it in a way that jobs are available and that the kids don't go hungry.

So we decided we wouldn't cut off benefits, bang, we will simply eliminate cash assistance if folks didn't cooperate with the program. And of course there will always be some that don't cooperate but that is a big enough stick to get them into the program.

What is our experience so far? It has been in operation since July 1. What has happened, the welfare caseload has actually gone up slightly because we are still in a serious recession, but the expense for each case has gone down significantly because we got rid of things like the 100-hour rule, which I encourage all of you to get rid of, and that allows people to go to work and they don't make enough to get off of welfare, they don't give up their job and go back to the system, they work and they get supplemented benefits.

So I think, Congressman, that the approach that we ought to take is a thoughtful approach and the emphasis ought to be on getting people back into productive lives, and it is going to take some requirements, not just a matter of the carrots. We all know that a lot of training programs and this and that don't do it. We have got to require them to work. We have got to limit the access to benefits if they don't work and we have got to craft it in such a way so that the kids who are, through no fault of their own, who are going to be victimized by whatever we do to the parents, are not victimized.

And if you break the entitlement, kids will be victimized in my view because—and I am not saying you have to have an entitlement at the current level of welfare. I actually don't agree with my colleague from New York. I think that you don't have to guarantee us the same amount of money that we had before. I would be happy if you would guarantee some minimum level of decency for the whole country which is an entitlement and block grant which you have got and go ahead and make us do different things and be flexible and so on.

But I think there should still be a national program with a lot fewer strings attached, and I think the individual entitlement has to be there because, in the next recession, children are going to be the ones that are in trouble, not the parents that we want to get back in the work force.

Mr. GIBBONS. Thank you, Mr. Chairman.

Chairman ARCHER. I should have announced earlier that Governor Pataki, because of his very tough schedule and the big problems in his State, has told us that he could only be here until 11 o'clock; is that correct?

Governor PATAKI. That is correct.

Chairman ARCHER. We wish you could extend that a little bit. If members will keep their inquiries as brief as possible, we can take the greatest advantage of Governor Pataki's visit here. I would encourage members to direct their questions to you while we have still got you because we will have Governor Dean for a longer period of time.

The Chair recognizes the ranking Republican from Illinois, Mr. Crane, for inquiry.

Mr. CRANE. Thank you, Mr. Chairman. And thank you both for your testimony.

On "60 Minutes" some years ago, they had a report where a darkened car was going down the streets of New York City. Maybe you saw that. They had a hidden camera in the back seat and they pull up to a prostitute at the corner and asked her how much she charges, and she said $100. And they said, what if we pay you in food stamps. And she promptly said, $200.

And they went on a little further and here was a dope trafficker, and I forget what the measurement was of whatever drug he was selling, but the thing was that he knew immediately that whatever the going price was, if you paid in food stamps, it was double just like with the prostitute. And they went on to point out that they were offered weapons, including stingray missiles, for food stamps.

And then they showed a couple of crooked grocery stores where the prostitute could come in and make the transaction turning in the food stamps and the grocer would give her $150 in cash and he pocketed 50 bucks in cash, too, for the simple transaction.

I don't know how extensive that sort of thing is, but I have heard other instances where, in poker games, food stamps were used. I mean, it is a currency and the people who work in that realm obviously know it is worth 50 cents on the dollar.

I remember back when I was a kid in Chicago we had township commissioners that delivered, literally delivered, food on a routine basis to those people in need and they were in a position then to maintain ongoing checks on their welfare. I am wondering if there is some reform in this category which you Governors have considered because this system obviously is abusive and it needs reform. But giving you block grants and letting you look at how to solve some of those problems, to me, is a sound concept and I wonder if you have any thoughts on that.

Governor PATAKI. I do. I think the problem that you are talking about is a very real one and I, as well, have heard the anecdotal reports of the use of food stamps as a type of currency for every other commodity but food that we would like to see. Let me agree with Governor Dean here very briefly when he pointed out how the school breakfast and lunch programs work because they were not a cash program, they were a program run through an agency that provided a direct service to the people so that there was minimal risk of abuse.

That doesn't exist with food stamps. It is a very real problem. I know that some States have looked at things like electronic benefit transfers where you would have a debit card instead of the stamps where the card would be charged and that could then be used in supermarkets where it would be run through like a credit card and the outstanding balance would be reduced as the commodities were purchased.

This type of change in the system can reduce fraud and allow us to continue what we in New York have always had, which is a very strong sense of compassion and support for those in need, but get away from a system that has far too much fraud involved right now.

So, again, I think what Governor Dean said where you have the direct delivery of a service through something like a school, that program makes sense. But when you have the potential for abuse as with food stamps, give us block grants and allow us to experiment as Texas and some other States have done with things like debit cards, and electronic benefit transfers. That is the type of thing that can be done in a laboratory of democracy where the States can try various approaches to see which works most effectively to deliver the service at the lowest possible cost.

Mr. CRANE. Well, I remember one other incident, and I can't help but feel that you folks have got more creative solutions to the problems than we have addressed here in this town, but so many instances beyond what I described of abuse and one as a well-dressed mother in front of me in the checkout line in the supermarket and she had a quart of ice cream or something and she gave him $20 in food stamps and they gave her change.

Now, that is illegal, but what are you going to do, put a cop at the end of every checkout counter? And she could take the money that she got returned to her and buy booze or buy cigarettes or whatever. So obviously it is something in need of reform and we look forward to working with you.

Chairman ARCHER. The gentleman's time has expired.

Mr. Thomas of California.

Mr. THOMAS. Thank you, Mr. Chairman. I thank both the Governors for their testimony, collectively, at least in your verbal remarks and I have been trying to look through your written remarks. The positions that you take seem to be relatively consistent in terms of the recent discussions about the way in which the Federal-State relationship could change. You are more than willing to accept the ability to make decisions in areas—for example, on page 6, Governor Dean, you say: In summary, States have the primary responsibility for critical services of high priority to citizens.

Clearly in Governor Pataki's testimony about moving to a block grant, maximum flexibility for the State, he wants historic levels of support. You said that is not totally necessary, but you need great flexibility. You really don't want to have to deal with taxes at the State level because, if there was a downturn in the economy, you would have to raise taxes. But you are in favor of a balanced budget amendment which, if it occurred at the Federal level, and there is a downturn in the economy, we are going to have to raise taxes to continue to fund you folks.

I believe the Chairman correctly pointed out one of the reasons it was so easy to do at the Federal level historically was because we simply ran up the national debt in providing you with the money. If we are going to have a balanced budget amendment, somebody is going to bite the bullet and raise taxes, you don't want it to be you, you want it to be us.

I guess in summary my response to you is, don't ask us what we can do for you but rather what are you willing to do for yourselves. And I mean it this way. If you want the areas of responsibility, instead of talking to us about the fact that we have to fund it, and Governor Dean, I appreciate your comment about everything on the table, but what you talked about with everything on the table were all Federal programs. You had to have Social Security on the table. For me, everything on the table is everything that you do as well.

Governor DEAN. That is right.

Mr. THOMAS. Now then, moving the discussion not to just moving responsibilities down to the State level but moving guaranteed revenue sources as well which are at the option of the State to use or other revenue sources if the State so chooses, but the Federal Government would believe that the funding mechanism sent with the responsibilities is sufficient but the choice of levying it or adjusting it would be yours.

What is your reaction to that idea?

Governor DEAN. My reaction is, nobody wants to raise taxes. We don't want to it do it and you don't want to do it, so if we are going to share responsibility, let us both share the responsibility of raising taxes if necessary, cutting popular programs if necessary. The reason I mentioned putting Social Security on the table is, one, it is anathema of cutting for every Member of Congress no matter what party you are in.

Mr. THOMAS. It is not to this Member of Congress. I have said from a long history that we have to look at everything. My point, you don't want unfunded mandates, you want funded mandates, you want us to fund it and you folks to make the decisions. I believe those are not the only two choices in front of us.

How about financed mandates in which you control not only the bulk of the decisions about the program but the bulk of the decisions about the financing as well?

The Federal Government carves out areas and says we will not tax at the Federal level, we will move it to the State level and the decision is yours, do you like that or not?

Governor DEAN. I think, again, Congressman, the Devil would be in the details. And I think we are going to have to discuss a lot of which kinds of taxes we could raise and which we couldn't. The income tax, for example, is a very difficult tax for States to raise because, if I raise my tax, then my businesses go to New York State and vice versa.

Mr. THOMAS. There are any number of taxes at the Federal level that we can move to the State. It is the concept that I am interested in.

Governor DEAN. I think it is certainly worth pursuing that.

Mr. THOMAS. At least that is a foot in the door.

Thanks.

Chairman ARCHER. The gentleman's time has expired. Thank you.

Mr. Rangel.

Mr. RANGEL. Governor Pataki, because of the shortness of time, I am going to send to you a lot of questions I need answers to in order to be guided as to what decisions we make here.

Politically, everyone talks about work, work, work, work, and it sounds good politically. I go back home and people keep talking about jobs, jobs, jobs, jobs. Now, you know that where we have most of these problems with welfare mothers is where the unemployment rates in these communities are two, three, four times the national average.

You also know that these kids that are involved in irresponsible acts have no training, have no ability to work. We have laid off so many in the low-skilled jobs. We have other jobs that people used to get in poor communities going to less developed countries. And so in this Contract there are no provisions as to what happens when there are no jobs, when there is no money for training, but it sounds good politically and so, what the heck, I am for making certain everyone works.

But we know that having—creating jobs and having training for jobs and getting the private sector to work with us avoids these unwanted pregnancies. Jobs mean dignity, pride, it means family values, planning for children. It means having hope for the future. It means not having pregnancies that you don't want. It means not getting involved in drugs and violence and crime. It means that you feel a part of America. But just saying you should work, it ain't going to work out.

You didn't say you support this Contract With America and so, therefore, we have to find out what this Contract means for the people of the great State of New York. Everyone wants block grants and flexibilities. How much money do we get now?

If you are for the Contract, you are for a balanced budget. If you take off 50 percent of the cuts in order to balance the budget, New York City is a big target, New York State is a big target, and if we lose entitlements, don't trust the Appropriations Committee because they don't sign any contract as to where they are going to cut.

And so before you sign the Contract, please ask our friends on the other side to produce for you where they are going to raise the money to balance the budget because we have more than our share of poor, because we have more than our share of newcomers into the country. We have more than our share of people that are entitled and if we can't do it with partnership with the States, our constitution requires that we in the State of New York take care of these people. So I know your time is limited, but we have to talk before we sign the papers.

Governor PATAKI. Congressman, let me just say that I appreciate your comments, particularly about jobs. And I was trying to chuckle inside when Governor Dean was talking about what happens if we have a recession because, in New York State, we have missed out in the national recovery. There have been millions of new jobs created nationally since April 1991 and, in that same timeframe, New York State lost 300,000 jobs while the rest of the country was growing.

And I think it is because we tax too much, we spend too much, and we overregulate, and we have got to dramatically change New York State's economic climate to create those jobs because you are absolutely right. It is a job that creates the support for the family and the ability to have the sense of pride and self-worth that comes with being a contributing member of society and we have got to do that at the State level and we are going to.

But when we talk about welfare reform, it is not simply private-sector jobs, it is also as was done in Westchester County where, when they put in place their pride in work program, they came up with community service and they required the home relief category of welfare recipient to show up during the week to go to job training, to go to drug and alcohol abuse training so that they would then be able to work. And in the absence of a private-sector job, they performed community service. The results in Westchester County were that the home relief rolls fell by over 25 percent in 1 year.

And I think we can replicate that in the city of New York, in the State of New York, and that is why I have named as our social services commissioner the commissioner from Westchester who put in place that program in New York—in Westchester County, so I think we have to do both. We have to create the job training and the support so that the people do have the sense of self-worth to go out and work and that comes from community service, but we also have to change the economic climate in the State to start attracting the private-sector jobs that have gone elsewhere and not in New York State.

You talked about, in the balanced budget, how is Congress going to raise the money. I don't think it is simply a question of raising money. I think it is also a question of cutting spending. I think that is something you have to look very seriously at as we are looking very seriously at in Albany. We are going to spend less money in 1995–96, fiscal year of our State, than we did in 1994–95.

The mayor of New York City is spending less money in this fiscal year than he did last year. The Governor of New Jersey did it last year, spent less than the year before. And I think Washington has to look not simply at taxes as the solution to a budget that is out of balance but also where spending can be cut.

And if I just might make one further comment. I want to repeat the request I made, Mr. Chairman, at the beginning that in response to Mr. Neal's comment, that we are looking to reduce our Medicaid costs in New York State to the Federal Government next year by $2 billion, approximately. If there were an incentive at the Federal level for States that lower the costs of their entitlement programs, whether they be Medicaid, long-term Medicaid, acute care home relief, AFDC, any of these programs, if there is an incentive at the Federal level where the Federal Government will share some of saving, they get with States that lower their costs, I think we could both help you to move toward a balanced budget by lowering the obligations, the bills that the State send to you and help us to achieve the reforms necessary to balance our budgets and break the entitlement cycle of dependency where it is not a question of how much we spend, it should be a question of how successful we are in moving people from these entitlement programs to a life of self-worth and contributing to society.

So, Congressman, thank you for the question.

Mr. Chairman, thank you for the opportunity to be here. I am sorry that I do have to leave but this was something that I think is very important and I look forward to the changes coming out of Washington and hope that we continue to have a cooperative dialog between the Governors and certainly me and the members of this committee in the House.

Chairman ARCHER. Governor, thank you very much for your outstanding input today. Our door will continue to be open for dialog but, not only that, we will be knocking on your door so that we can continue to have this pattern of reaching out in cooperation, exchange, input, so we can develop a program that is the very best for the American people.

We understand your schedule and you are excused. We thank you for being with us.

Governor PATAKI. Thank you.

Chairman ARCHER. I would like to, with the indulgence of the committee, also intrude on the normal inquiry procedures by recognizing that we now have with us Governor Weld of Massachusetts. We fully understand what delayed you and we regret that you could not be here earlier, but we are prepared at this time to entertain your testimony.

As I mentioned to your colleagues a little earlier, you will not be limited by our normal 5-minute rule, but we would hope you would keep your oral presentation as short as possible and any written testimony that is more extensive, without objection, will be inserted in the record.

Welcome, Governor Weld. You got a real introduction because I think you are probably by now pretty well known to most Americans.

STATEMENT OF HON. WILLIAM F. WELD, GOVERNOR, COMMONWEALTH OF MASSACHUSETTS

Governor WELD. Well, thank you so much, Mr. Chairman, and members of the committee, and especially my former boss, Representative Crane. It is a real pleasure to appear before you.

I think a lot of what we have gone through in Massachusetts in the last 4 years really connects with the Contract With America both in letter and in spirit. If I have just one message for the members of the committee based on our experience, it is to be bold and strike at the outset while the iron is hot. That is what we did back in 1991.

As Congressman Neal could tell you, Massachusetts was a basket case at the beginning of 1991 when I came into office. On a budget of about $13 billion, we had an $850 million shortfall for the current year and a $2 billion shortfall for the year we were just coming into for about a $2.5 billion deficit that we had to close in a big hurry. We did close that deficit, and we did it without raising taxes.

The first thing we had to do was change the culture. During prior years, Massachusetts had gotten into the habit of deciding how much money it wanted to spend at the beginning of the year and then adjusting the tax rates upward or going to Wall Street at the end of the year to help get a sufficient amount of funds to meet the plan.

We had to make the culture the opposite; to figure out how much money we are going to have and to budget accordingly.

And we did as Governor Pataki was just referring to, we did cut spending in absolute dollars between 1991 and 1992. We spent less in 1992 than we did in 1991 and there were a lot of howls of protest, although I would say, in my judgment, the howls were mainly from advocates for various interests that had been well represented in the past—often paid advocates—

And the conversation that we had time and again with the people who were complaining about budget cuts was: We know this isn't like 1988, but that was then and this is now. We have not only had an election in which the bombthrowers won the primaries in both the Republican and Democratic parties in 1990 in my State, but we also had an economic situation that people would just not put up with.

So we had to find that $2 billion—and that is equivalent to about $200 billion in your budget—and we did it by going after the big ticket items, the so-called budget busters, and our iron was hot because we were almost in bankruptcy. The iron is hot down here now more for political reasons but the lesson is the same.

I will spare you the details, Mr. Chairman, but we significantly cut Medicaid sharply by moving to a managed care system. We significantly cut spending in the transportation area by flattening the management structure, moving from 13 layers to 5. We consolidated our Department of Revenue but because they put in private-sector mechanisms, they are raising more money than ever before.

The Contract proposes to do more with less. That has been more than a slogan in Massachusetts in the last 4 years, and I think it can and will be here. Personally, I consider the balanced budget amendment to be the cornerstone of the Contract. All the States balance their budget every year, Mr. Chairman. Forty-nine States, all except my brother State here, have a balanced budget requirement in their constitution. He is such a good frugal person, he balances his budget anyway.

But you know we haven't raised taxes. We haven't gone to Wall Street to borrow a dime. We cut the State work force by 12 percent the first year, from 72,000 to 64,000. We have cut taxes nine times. We cut the capital gains, the estate tax, the income tax, and the sales tax—and what happened? Our tax revenues went up. They didn't go down because people began to think maybe this isn't "Taxachusetts" so maybe we will invest here. So our tax cuts very much mirrored those in the Contract, which I would endorse.

Finally, we are reforming welfare. I think the block grant proposals that are kicking around the Hill are very much worthy of adoption. I note that the States can make huge savings if they are given the authority to manage these programs. I could save $60 million a year if I just managed the supplemental security income program. I have given Congressman Kasich a proposal that would save him $2.5 billion if the States had authority to manage that program because we would impose a meaningful screen, which is not being done now.

I would also endorse the provisions in the Contract about child support enforcement and adoption. Those are two areas that really need to be emphasized. That spans the Liberal-Conservative spectrum, too.

So I would just say in closing, Mr. Chairman, I have yet to receive a single letter complaining about those 8,000 people who don't work for the State anymore, and I think something like the same in percentage terms can be done at the Federal level. I congratulate you all.

[The prepared statement follows:]

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WILLIAM F. WELD
GOVERNOR

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LIEUTENANT-GOVERNOR

Testimony of Governor William F. Weld

Hearing on the *Contract with America*

Before the Committee on Ways and Means
Thursday, 12 January 1995
Washington, D.C.

Thank you, Mr. Chairman.

I appreciate this opportunity to testify, because much of what we have accomplished in Massachusetts over the past four years connects with the Contract, both in its specific provisions and its spirit.

As Congressman Neal could tell you, the recession hit Massachusetts first and struck deeply into our economy. When we came into office in January of 1991, state government had an $850 million deficit we had to cut in our first month, and a $1.8 billion structural deficit we had to resolve by June of 1991. Put another way, if Massachusetts had been a person the State House might have been sold at auction.

We did close the deficit, however, without raising taxes or borrowing, and we faced many of the same obstacles that I suspect will confront the Congress as it works to enact the Contract.

First, we had to change the culture in Massachusetts. We had to reverse the ethos that equated raising taxes with courage. Second, given our blood oath not to increase taxes, we had to cut the budget, with howls of protest ringing in our ears.

Since $2 billion dollars in the Massachusetts budget is equivalent to about $200 billion in the federal budget, we were talking about a general anesthesia, in-patient operation -- not just a trip to the pharmacy. We had to go after the so-called "budget-busters," big money programs with broad constituencies.

The first of these was Medicaid. Medicaid spending in Massachusetts grew by 90 percent from 1987 to 1991. Since we implemented managed care Medicaid in 1991, however, Medicaid spending has grown by less than five percent each year, and by only two-point-nine percent last year.

Managed care has not only helped us to balance our budgets, it has improved the quality of service. Four years ago, most of the children relying on Medicaid had no primary-care physician and no access to decent prevention. Many were not even getting their shots. Now, a little girl with an earache need not resort to an emergency room visit to receive medical attention; she has her own doctor who knows her by name.

Another "budget buster" was the mass transit system serving Greater Boston, which some of you know as the "T." Back in 1991, our Transportation Secretary saw a news report that showed subway workers putting in two-hour days. When he inquired about firing those workers, a word I use ironically in this case, he discovered thirteen -- thirteen -- layers of management between him and the problem. Now there are five. Owing partly to this change, our Transit Authority has reduced its operating budget by $70 million over the last two fiscal years. This is big money in a $16 billion state budget, and we were able to accomplish the cost reduction without reducing services.

There is a similar story to tell about our Department of Revenue. Despite having twenty percent fewer employees and a reduced budget, they are still able to process returns and send refunds faster than before the reductions. By using computers and adopting private sector management techniques, they can now get refunds out in four days for those who file by phone, and at half the cost of the old paper system.

The Contract proposes to do "more with less." That has been more than a slogan in Massachusetts, and it can be here, as well. I consider the Balanced Budget Amendment to be the Contract's cornerstone, and balanced budgets are achievable. We not only have balanced our budgets, but we ended last year with a $326 million surplus. We've reduced the state workforce by 12 percent, from 72,000 to 64,000. And we've cut taxes nine times.

Many of our tax cuts mirror those in the Contract, such as a Research and Development Tax Credit and a repeal of our estate tax. We even recently approved a capital gains tax phase-out. After cutting taxes nine times in four years, my sincere hope is the Taxachusetts label is dead and buried.

I was pleased to see the Congress act quickly on the Contract's call for a three-fifths majority to pass a tax increase, something I would support even if the Constitution needs to be amended. Tax increases touch upon freedom, the central concern of both the Constitution and the Contract, and that makes the supermajority requirement sufficiently weighty to deserve Constitutional attention, if statutory action is impermissible.

We are also reforming welfare in Massachusetts, and the block grant provision I've been working on with Governors Engler and Thompson and Congressional leaders would give us the freedom to make the radical change we believe is necessary, and give other states the same freedom to follow their own lights. In Massachusetts, we want to implement a work requirement after 60 days and abolish the cash grant. To replace the cash grant, we want to give people the supports necessary for them to go to work: day care and health care.

We have recognized, as well, that child support enforcement and adoption are natural complements to welfare reform. We have more than doubled the number of AFDC families leaving welfare because of increased child support enforcement. We have also set a new record for the adoption of children in state custody. Child support enforcement and adoption are two more elements of the Contract that I endorse unreservedly.

Government flatters itself when it attempts to match every tendency and affliction in society with a program, regulation, or mandate. I do believe that what we have done in Massachusetts asserts the possibility of revolutionary contraction within government, the expansion of freedom outside of government, and prepares our state to function within the entrepreneurial mood that the Contract itself asserts. We did hear howls of protest in 1991, but despite large budget cuts and vast change, we have not heard genuine cries of pain. So my most general message to the Committee is to stay true to the spirit of the Contract, and strike while the iron is hot.

Thank you.

Chairman ARCHER. Governor, thank you for your outstanding testimony. We will continue now with the order of inquiry, and the next in line is Mr. Bunning.

Mr. BUNNING. Thank you, Mr. Chairman, and I would like to thank the Governors for being here and their enlightened testimony.

I would like to ask both of the Governors if your States were permitted to run their own welfare program using Federal funding with minimal interference from the Federal Government, would the residents of your State benefit and would you explain how they would benefit?

Governor DEAN. Well, as I have—for the record, let me just say, while we are all talking about what we have done in our budgets, I am about to submit my fifth budget in a row that is less than the rate of inflation. And when I became Governor—since I have become Governor, I cut the highest tax bracket in Vermont from 40 percent of the Federal levy to 25 percent and everybody else is from 28 to 25.

I just want to establish my credentials as a fiscal conservative since my colleague has insulted me by saying our State constitution, which is perfectly true, doesn't require a balanced budget.

Let me respond just briefly by saying or by reiterating what I said earlier about our welfare program. We have a statewide welfare reform program so the risk for us with welfare reform is pretty much on the downside, that is, we have already required work, we have already limited benefits after a certain time period.

The risk for us would be the problem that I laid out earlier, if you really block grant the whole thing with minimal interference, the big risk for us is that kids in a recession will be the victim of a political fight about whether we are going to raise taxes to have a minimum standard of decency or whether we are going to simply cut people off the rolls because there is no longer a Federal entitlement, so I believe we ought to have more flexibility.

I fully concede that States are—to Mr. Thomas' point that States will have to contribute to that and we will not do as well budgetarily. I just ask that we share that pain so that we all take political heat for the things we have to do in our particular case because we have already had welfare reform. I am concerned about the children being at-risk if the entitlement is broken.

Mr. BUNNING. Governor Weld.

Governor WELD. Well, Mr. Congressman, I think both Federal and State taxpayers would be big winners if that program were adopted. There would be no loss of services. Governor Engler, and myself, and Governor Thompson have proposed a block grant approach whereby States would be capped at the average of 1992 to 1994 AFDC spending. The Feds would not put in any more money for the next 5 years until the year 2000. That would mean, next year, for me, a $20 million cut in Federal aid—money you all would have to balance the budget with.

But I would be more than happy to make that trade. As I mentioned a moment ago, I could save $60 million if I were permitted to manage the eligibility for the supplementary security income program.

We had a State welfare program my first year, all-State, which I vetoed down to zero. I said, you have got to make it not an entitlement if you want me to put any money in this program. And so it was made not an entitlement and we imposed a meaningful screen. The spending in that program went from $270 million to $104 million the first year. That is $160 million which is real money for my State.

You know, I understand what Governor Dean is saying about possible downside risk. But Governors are elected to be leaders of their States; I don't know any 1 of the 50 Governors who is terribly interested in seeing kids starve out there on the grates. I think we are smart enough to make choices that will prevent our most vulnerable populations from really taking it on the chops.

Chairman ARCHER. The gentleman's time has expired.

Mr. Ford.

Mr. FORD. Thank you very much, Mr. Chairman.

And to the Governors, let me thank you for your testimony.

Governor Weld, you mentioned in your closing statement about child support enforcement. Should child support enforcement be included in this block grant program itself?

Governor WELD. I think child support enforcement should be left to the States. I think that it is really coming into its own as a topic of focus. In my State, we publish 10 most wanted posters, 10 fathers, or usually fathers, that owe the most in child support enforcement—just like in the post office.

Mr. FORD. That hasn't been true in most States. The Federal Government really has been the one that stepped in to enforce child support enforcement over the years, has it not been?

Governor WELD. Our Department of Revenue has really run with that issue, and I think the States are now vying with each other to be more aggressive in child support enforcement. I think the obligation of fathers—it had been left on kind of a side burner, but I think as a political and moral and social issue, that is really getting huge emphasis now in the States.

Governor DEAN. Let me respond to that, if I may, Congressman.

Mr. FORD. Go right ahead.

Governor DEAN. What you are hearing from me is sort of the most people could accuse me of being a raging Moderate. I am anxious to have some of these changes, but I am not anxious to totally restructure everything and the reason is this: States already have, at least in New England, taken the ball and run with it on child support.

We have the highest child support collection in the country right now. It is not very good. It is in the 20-percent area but it appears to be the highest in the country. Without some kind of Federal participation, it is not possible to do this because the toughest time that we have is fathers who have moved out of State and we can't find them.

I am not—you know, we are not here as Governors saying, get out of our face and let us do everything. We need the help of the Federal Government in some areas. I think Congressman Thomas' point is well taken, we can't be hypocritical about this and we are going to take some hits.

We are not looking to divorce ourselves from the Federal Government and I would submit that there is a role for child support enforcement at the Federal level. We can argue about what that role is, but I don't think it is a reasonable position to suggest there is no role.

Mr. FORD. You know, there is very little child support enforcement in the Contract With America under the Republican's bill. Would you suggest, Governor Weld, that we would include the child support enforcement in any welfare reform or block grant program to the States?

Governor WELD. I had thought there was more than reference in there to child support enforcement so I would say yes.

Mr. FORD. And do you think that we ought to really focus, you know, on the deadbeat dads a little bit more than trying to just focus on children and women after welfare and penalizing women and children and not going after the deadbeat dads?

Governor WELD. Yes, Mr. Congressman, I completely agree with that. Our welfare proposal in Massachusetts envisions that 7,000 out of our 107,000 families would be off the rolls as a result of stepped up child support enforcement.

Mr. FORD. So child support enforcement, you, Governor Dean and Governor Weld, feel strongly that it should be included in this welfare reform package that we are going to probably adopt in this Congress?

Governor DEAN. I think that is an excellent idea. I have said before and I say again that we have got to make sure that fathers have a much greater responsibility for their kids, both in and out of wedlock, and I think anything to do with child support or paternity establishment is a good idea.

Mr. FORD. Thank you very much, Mr. Chairman.

Chairman ARCHER. I thank you for your responses on that. There is clearly total bipartisan support in the Congress for the toughest possible child support enforcement. It was accelerated dramatically during the Bush administration and we have to continue to pursue every part of what is our appropriate role, as you mentioned, Governor Dean, in assuring that that does come to pass in any welfare reform.

Mr. FORD. Mr. Chairman, just in my comments, though, I did think the issue, how soon will we get to the child support enforcement? Will we combine or will we merge child support enforcement with welfare reform? And if not, how soon will we get into the child support enforcement?

Chairman ARCHER. The subcommittee has been instructed to concentrate on this issue and make it a priority in the development of this policy.

Mr. CAMP. Mr. Chairman, in Mr. Shaw's absence, as a member of the Human Resources Subcommittee, we plan to do that in the next several months and we will have a bill this year.

Chairman ARCHER. Mr. McCrery will inquire.

Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

Governor Dean, I read with interest the Washington Post article which reiterated your comments about the Republican welfare proposal. And, you know, if my wife had read that or someone not in politics and not accustomed to being barraged by the press all the time, she might get mad or somebody might get mad. I don't and I don't think anybody here did because we understand that in an unguarded moment when a question is put to you by the press, and you may say some things that you don't really mean or you would like to take back and maybe look at it a little more closely, so I am not going to go over all those things with you.

But Governor Weld is right, we have an opportunity here to strike while the iron is hot and I think the Governor's advice is going to be very well taken by the majority in the House and I think in the Senate.

We are going to do some things, perhaps very drastic things with respect to welfare reform and other areas of the Federal budget, so we are hopeful that you and your association, even the Democrat Governors around the country will work with us and help provide us good information, as you are trying to do today, so that we can fashion some policies that make sense for the country and for the States.

Governor Weld, before you arrived, Governor Dean said that, in his opinion, you can't have real welfare reform without spending more money. Do you agree with that proposition?

Governor WELD. No, actually I don't, Mr. Congressman. I am basing that answer on my experience in my State. As I say, we were able to cut the amount for the general relief welfare program very substantially by just managing it more tightly. Beyond that, if we do move in the direction of more of a block grant approach, as opposed to the Governors having to go to Health and Human Services for a waiver any time we want to try anything a little bit different, I think that we are going to save money.

I think that a certain number of cents on the dollar, whether it is 5 or 10 or 15 or 25, gets peeled off when the money is coming down to Washington and coming all the way back down to Main Street.

Mr. MCCRERY. Thank you for that acknowledgment. And thank you for sharing with us the benefit of your experience in Massachusetts.

Frankly, Governor Dean, I think if this Congress were to propose a welfare reform proposal that spent more money on welfare than we are currently spending in the Nation, we would get laughed out of here by most of the constituents who elected us, so we are going to—I am hopeful that we are going to pass a welfare reform proposal that is tough, that does save money, and yet does not throw people out in the streets and all those harsh things.

So I hope that all of you will work with us to try to fashion something that will save money for the American people and yet deliver a compassionate safety net for our population.

Thank you, gentlemen.

Chairman ARCHER. Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman.

I want to thank both of the Governors for their testimony. Governor Weld, you have touched on this in an answer to Congressman Bunning, one of the arguments used in maintaining the status quo or the Federal entitlement nature of many welfare programs is their role as sort of automatic stabilizers depending on bad economic times, welfare spending increases automatically and that helps locally in regions of the country.

If we do attempt to adopt a block grant proposal, do you believe that that can be drafted to adjust for that concern?

Governor WELD. Well, at one level, Mr. Congressman, I would say that Governors are constantly adjusting to changing economic times. States go through both local and national business cycles. So to some extent, we always have to adjust and juggle our priorities as we go along.

Beyond that, there is a whole range of options for the Federal Government to take in designing a block grant program. You could design a block grant welfare program, as I think some members of the subcommittee may have in mind, saying here is the money but we want a work requirement, we want some time limits, and we want to cut down on illegitimacy among teenage—children born to teenagers. You can make those conditions of the money.

Governor Engler and I would prefer you not go quite so far. Maybe you could adopt a model that would be more along the lines of an assessment, saying we are going to suggest these things as goals and we are going to assess how you are doing. Well, if you in Massachusetts don't do anything to reduce illegitimacy and at the end of 1 or 2 years your illegitimacy rate among teenagers is 49 percent and everyone else's is 12 percent, well maybe some tripwire will be kicked and you will lose some money or we will tell you you have got to do something.

That would be perhaps an approach that would put a little bit more freedom in the hands of the States. In any event, I don't think we would be really any more subject to the swings of business cycle than we already are. I think we could use the savings that would be engendered at the State level to perhaps build up our rainy day fund against that day. When I came in, we had no rainy day funds. Now we are running a $300 million surplus and we have developed a very substantial rainy day fund.

Mr. CAMP. Governor Dean, you mentioned that you wanted to explore the paternity establishment question a little more and I wonder if you had any specific conditions to what is contained in the majority bill that you would like to tell us about.

Governor DEAN. I don't. I think that there are times when it is probably not reasonable to expect that the paternity can be established and to put off benefits entirely as a result of that is probably a mistake. But I don't—I want to be careful in my remarks because I think it is a question that needs to be addressed and I think the only recommendation I would make is that we be careful, again, to think of children and how they are going to be treated in this system.

So that I probably wouldn't go quite as far as what is in the majority bill, but I think something along those lines needs to be done, and I would be happy to work with you as an individual or get the NGA to work with you in that regard.

Mr. CAMP. Thank you very much.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Matsui.

Mr. MATSUI. Thank you, Mr. Chairman. I would like to direct my questions to Governor Weld. And I thank you both, Governor Dean and Governor Weld, for being here today.

Governor Weld, your program in your State in terms of the job training and eventually finding a job for many of these people who are on welfare, I understand, is reasonably successful. What is your success rate at this time and how many people do you have that are actually participating under the JOBS program at this particular time?

Governor WELD. We place about 8,000 a year and, in the Temp-Up program, our success rate is much higher. Of course that is pursuant to the 1988 Federal act for two-parent AFDC families and therefore we have everybody in the program. And 3,000 out of 7,000 families there are now off the rolls entirely because of their earnings in the private sector.

Mr. MATSUI. Do you know what the percentage is?

Governor WELD. It is 100 percent for Temp-Up.

Mr. MATSUI. I am talking about——

Governor WELD. People actually placed by jobs off welfare, it is 8,000. And my caseload is 100,000 if that is the percentage you are looking for.

Mr. MATSUI. So you are saying about 8 percent is your success rate?

Governor WELD. That includes a universe with the disabled and people caring for disabled who are not really candidates for this.

Mr. MATSUI. Assuming about a third of those 100,000 are disabled. I don't know——

Governor WELD. Fifty percent.

Mr. MATSUI. Fifteen?

Governor WELD. Fifty percent are disabled or caring for disabled.

Mr. MATSUI. The most successful program that has been studied, and there are many programs that have been studied since the 1988 Family Support Act was enacted, has been completed, has been in Riverside County. I am very familiar with it even though it is 200 miles away from my district, Riverside County, Calif., and the success rate is about 23 percent, and that means obviously the failure rate is about 77 percent.

And I am just wondering, you know, action given the fact that you do favor block grants, and I am assuming your program is not as successful as the Riverside County one, otherwise—if I am incorrect, could you correct me on that.

Governor WELD. Well 8 out of 50 would be a little bit below that.

Mr. MATSUI. Yes. That being the case, what do you do with the remainder of them, particularly if you have a period of low unemployment? How do you deal with them? Do you provide community service jobs?

Governor WELD. Well, our proposal, and it has not yet been passed in our legislature, Mr. Congressman, but our proposal is to have everybody go to work. And I can finance that by abolishing the cash grant. If I abolish the cash grant, that frees up so much money that I can offer everybody who is able bodied full-time day care and health care.

Mr. MATSUI. So what you would basically be doing is then to set up a situation where you would be providing community service jobs for these people; is that correct?

Governor WELD. For those who cannot be placed in the private sector.

Mr. MATSUI. You feel you can do, obviously, day care or you feel you can do transportation and you feel you can do health care for all these people for——

Governor WELD. I don't do transportation. I do day care and health care.

Mr. MATSUI. Somebody is going to have to get them to work and that is a cost these people incur.

Governor WELD. Our projection, 8,000 of the 55,000 covered in our able-bodied universe, 8,000 would get jobs through our welfare Massachusetts Jobs Department; 7,000 would be lifted off the rolls by increased child support enforcement; 7,000 would find jobs in a newly expanded day care industry which, obviously, with everyone getting day care benefits, is going to become much larger; and 5,500 would be subsidized community services.

Mr. MATSUI. If I could just ask one final question and you could answer this very quickly. If we block grant these programs, you would not have any problems, then, of us having participation rates, success rates. I think you answered Mr. Camp's question positively on that.

In other words, if we said by the year 2001 you had to have a 75 percent job placement success rate, you would not have any problems with that?

Governor WELD. I think output and result measures are appropriate.

Mr. MATSUI. You would agree with that?

Chairman ARCHER. The gentleman's time has expired.

Mr. Ramstad.

Mr. RAMSTAD. Thank you, Mr. Chairman.

I, too, thank both Governors for being here today. I would like to revert to tax policy. We know Governor Weld that, under your leadership, you have cut taxes nine times while increasing State revenues and balancing the budget.

I would like to ask you which of your tax cuts you believe has generated the most economic growth and created the most jobs?

Governor WELD. So far, Mr. Congressman, it would be the research and development tax credit because that went through in 1992. We took California's tax cut, which was the most generous in the country, doubled it and enacted it. But over the long term, I think the most recent tax cut, a phaseout of the capital gains tax based on the holding period of the asset, is going to have the most impact on the economy.

People know if they hold an asset for 6 years, whether it is real estate or a share of stock, then they are not going to have to pay any tax. That is going to reward patient capital which is what we need for the high-tech industries of the future.

Mr. RAMSTAD. Have you also indexed capital gains?

Governor WELD. That is really an extreme form of indexing. Our capital gains is 6 percent, and I knock off 1 percent for every year you hold the asset. It is the Jack Kemp proposal.

Mr. RAMSTAD. I see. Exactly my thought.

Final question, Governor Weld. Which if any of your tax cuts were directed specifically at low-income working families?

Governor WELD. Well, we increased the head of household exemption. We have increased the exemption for dependents which is something that I commend in the Contract, and we have raised our no tax status threshold from 11,000 to 13,000, the point at which you pay no taxes whatsoever, and we have expanded the availability of our low-income tax credit.

Mr. RAMSTAD. With reference——

Governor WELD. Four of our nine are aimed at what could be called low-income wage earners. One is a general income tax and the other four are more targeted toward business and job creation.

Mr. RAMSTAD. Perhaps just a final question, Mr. Chairman. Perhaps it is too early to quantify the results but, thus far, have you been able to measure any improvements in the economic situation of this population group or correlate any?

Governor WELD. Our unemployment rate has gone down from the highest in the country, just under 10 percent my first year, to below the national average the last year. That is 100,000 more people working but that is not atypical, so it is kind of hard to say there is a direct cause and effect relationship although, as a committed supply sider, I of course think there is.

Mr. RAMSTAD. As a fellow supply sider, I thank you, Governor, for bringing your message to Washington. We need to hear it.

Chairman ARCHER. Mrs. Kennelly.

Mrs. KENNELLY. Thank you very much. And welcome, Governor Dean and Governor Weld. Governor Weld, I am from Connecticut so I follow your State. You were bold. You suggested 60 days and you are off. Then of course your legislature changed it dramatically and you vetoed it, and now you are back.

And I followed your program and commend you for it, but I do see that you have child care there and you do have a job provided, so I hope we can do that as well. But in the meantime, I welcome you, Governor Dean, because I came back here ready to look at the Contract and be involved in that exchange, and then the next thing I know, welcome to the block grant world. And at least you put your hand up and said, stop, let's think about this.

And I really thank you for that because I think you are saying to us, you and I know and everybody in this room knows, we are going to raise taxes or we have got to cut spending, and if you can't cut spending or raise taxes, well, take a block grant and send it to the State. And then you get back to the State and the State doesn't want to raise taxes, so they are going to have to cut spending. So this is going to have an effect in the cities. I am just glad you are giving us an opportunity to think about the block grant and the ramifications for the individual States. I know from the Northeast to the Sunbelt, it could be a big shift.

Could you expand a little bit more on that. Are you talking about welfare and AFDC being a national interest. I caught it quickly last night when you were on "Crossfire," and today I heard you, but I didn't quite get it completely. Would you review that?

Governor DEAN. Thank you. Let me respond by saying, with all due respect to my colleague from my southern border State, I find it—I am the only Governor in the country who has a welfare program, statewide welfare program that requires work and that limits benefits. I wonder what is going to happen. And no one in the committee or Governors' Association has answered that for me.

What happens when there is a recession and there is no job available? We found it necessary to create public jobs in order to require people to work and that takes money to do that. And so I will reiterate my belief based on experience, that the kind of welfare reform that we are talking about here, which I fully support, is not possible when we are cutting large numbers like $40 billion.

I believe welfare is intended to be a safety net and I think it has gotten out of hand. I wouldn't push the clock back 50 years. I would probably do it 25 years. We need a safety net, particularly for children. We need to make people work. We need to have time-limited benefits.

What I would request of the committee and of the Congress as a whole is to do this in a reasonable, thoughtful, moderate way, keep what is good about this program. It was started for a reason and throw out what is bad about this program, as many of us have around the country.

Mrs. KENNELLY. So very quickly what you are saying is, with a block grant you get a certain amount of money, then those on welfare use up that money, then you have a recession and somebody who has been working and gets laid off and due to no fault of their own has to apply for welfare, the money might be gone?

Governor DEAN. That is right. Under the scenario of total block grant and no national minimum, we might have to take benefits from other people on the program and we might have to deny benefits to people who have been working all their lives and have not been on welfare because the benefits may have been used up by people already on the program.

This needs a lot of thought.

Mrs. KENNELLY. Thank you, Governor.

Chairman ARCHER. Mr. Zimmer.

Mr. ZIMMER. Thank you.

Governor Weld, before you arrived, Mr. Neal gave an opening statement in which he said he has been waiting for a phone call from any mayor or any Governor willing to give up some Federal support for welfare or other programs.

Governor——

Mr. NEAL. Would the gentleman yield for a moment. I don't think that is what I said at all.

Mr. ZIMMER. Could you put it in your own words.

Mr. NEAL. I said I have yet to receive a phone call from any Governor or any mayor who was willing to send back Federal dollars for projects.

Mr. ZIMMER. OK. I stand corrected. I thank the gentleman.

Governor Pataki responded by saying that he has a plan to cut Medicaid costs which would result in a savings to the Federal taxpayers of $2 billion. What is your response to that challenge by Mr. Neal as expressed in his words?

Governor WELD. Well, our proposal—and I have a waiver application pending with Secretary Shalala—our proposal to take over the management of the supplemental security income program would free up $60 million which we could either grab or refund to the Federal taxpayers. I suspect it would be refunded to the Federal taxpayers, if the proposal that Governor Engler and Governor Thompson and I were working on were adopted. We proposed block grants with the Federal funds capped at current or recent levels for the next 5 years.

If that were adopted, I think the hit to Massachusetts in the first year would be $20 million. I would be willing to eat that and more than that. I have said publicly up in my State that I would be willing to absorb a $60 million hit in that area because I think that being able to manage the program translates not just to flexibility but to dollars at the State level.

Mr. ZIMMER. Thank you.

Governor Dean, do you share the view that flexibility equals dollars?

Governor DEAN. No. I support flexibility but not to the degree that Bill and Tommy and John do for the reasons I have stated. I think flexibility is important to make the program work better. You know, the total administration budget is about 12 or 15 percent in welfare. Even if we could somehow be twice as efficient as the Federal Government, we are going to save 6 percent. We are not talking big bucks. Furthermore, welfare is not a big program in the grand scheme of things in terms of Federal budget.

So I think we may be able to save a small amount of money but I think the flexibility is to get a better program targeting more and allowing States to get out ahead and push the envelope.

Mr. ZIMMER. I would like you to elaborate on a point that you made a while ago. You said, while you don't agree with the block grant approach, you would be willing to have Congress reduce the minimum amount of the entitlement for welfare.

Since it is our objective to get spending off of this steep trajectory, how would you propose that we accomplish the same result by reducing the minimum?

Governor DEAN. When I say I don't support a block grant, I don't support it in the way that my three Republican colleagues do. A partial block grant sounds terrific, and what I would propose, and this is again speaking as an individual Governor, I would propose that there be a minimum standard of grant throughout the country with an entitlement and that block grant over and above that and then go ahead and level fund that.

If we have to reduce benefits in the high benefit States, so be it. But at least every American and every child is guaranteed that they are going to be taken care of in bad times and maybe we can work out an approach together if there is that willingness to be bipartisan that will allow us to do that.

Mr. ZIMMER. Thank you.

Chairman ARCHER. The committee should be aware that Governor Dean has an engagement that is going to require his leaving I think at this time; is that correct?

Governor DEAN. In about 3 minutes, yes, Mr. Chairman.

Chairman ARCHER. About 3 minutes, all right. So we would be pleased to have you for another 3 minutes and, at that point, you certainly will be excused to attend whatever the event is you have to go to.

Ms. Dunn.

Ms. DUNN. Thank you, Mr. Chairman. And welcome Governors. As a fairly new member of this committee, and having the opportunity to hear testimony for the first time in these past 3 days, I continue, Governor Dean, and I think I should tell you, to be startled by the degree of control you seem to be asking for by government over the life of the individual.

And I think what I would like you to do, if I may ask you please, is to contrast your views with the views of Governor Weld and what role you believe the Federal Government should hold as we design our welfare reform program, what role you believe the States should have and what should the individual who is involved in these programs be doing?

Governor DEAN. Thank you very much. It is a great question. I think that where Governor Weld and I differ in degree not in direction is that we both agree, and I think most Governors agree that the Federal Government should play a smaller role in our life, also, and in this program. I believe that the Federal Government, this is a Nation, that all 50 States are part of that Nation and there ought to be some minimum standards imposed by the Federal Government.

I believe that the States ought to have far greater flexibility, freedom from regulation, from the nitpicking kind of regulation that we have been subjected to and lots of other people have for a long period of time. Freedom to run these programs and administer them with a reasonable Federal oversight but not the nitpicking kind of auditing that we have had to do for many, many years but that we ought to be required, as Bill has said, to deal with some basic outcome and having to meet those kinds of standards because this is indeed a national program.

I believe the individual has a responsibility to do the best they can for themselves and their families, a responsibility to go along with any rights that they may have. And I believe that part of that responsibility is working to the best of your ability and contributing whatever it is you can contribute.

We are both moving in the same direction, as I suspect the Congress is, and the question again is one of degree. I do not want to see the Federal role eliminated. I do want to see more responsibility at the State level and at the individual level.

Ms. DUNN. And Governor Weld, could I ask you to respond to that question, please.

Governor WELD. I think Governor Dean and I do differ in degree. I think there is a certain amount of distrust of the States in Washington that perhaps had its origins in the civil rights struggles of the fifties and sixties. This distrust was carried over and applied to the economic area where it really didn't have a decent underpinning; I think it now deserves a burial. I think that you can afford to leave much more running room to the States.

I think a mechanism which you could all use—an assessment mechanism is entirely proper—is to make sure that you all aren't buying a pig in a poke. But obviously I prefer to move farther down that road than Governor Dean.

Ms. DUNN. Thank you.

Chairman ARCHER. Mr. Coyne. Mr. Coyne will inquire.

Mr. COYNE. Thank you, Mr. Chairman.

Governor Dean, in your testimony, you indicated that in our rush to do welfare reform here at the national level we might be surprised to find out that reforming welfare doesn't really reduce costs. In other words, you have found that in reforming welfare in Vermont, indeed it has cost some money to do it correctly. I wonder if you could elaborate on that.

Governor DEAN. If you are going to require people to work, they have to have certain supports. Most of the people on welfare are single mothers. Many of them have small children that are not able to go to school. In fact what we have said is if your children are small and not in school, we require a 20-hour work week and if they are in school, we require a 40-hour work week for just that reason.

We believe that middle-class women are not capable of working unless they have some kind of child care arrangement. Therefore, you have to supply that for women who are on welfare. Transportation is an issue in our State because we are a very rural State and there is not much public transit. But it is a significant expense, the creation of the public JOBS program.

I don't see how you can force people to work, which I fully support doing, unless there are jobs for them to work in. And if somebody can solve that dilemma for me, we had a recession not long ago when the national unemployment average was 7.5 percent or higher. There are a lot of people who wanted to work who couldn't find jobs.

What about the people who may not have worked for 8 years or longer? We are going to require them to work as we should. There has got to be some money there to put into jobs and if you don't have the money, and I am sitting here telling you that as the only Governor in a State that has a program like the one you are talking about creating.

Mr. COYNE. Thank you very much.

Governor Weld, in Pennsylvania, the State I represent here in Congress, if the balanced budget amendment was to be implemented, it would cost us about $3.1 billion or more each year. And if we were to look at some way to raise that additional revenue, it would mean that Pennsylvania taxpayers would have to be taxed by the equivalent of an additional 12 percent across the board. I am just wondering if that is the kind of message that Governors want to receive from Washington.

Governor WELD. Well, Mr. Congressman, if the antiunfunded mandates bill that is now before the Congress passes, I suspect that that $3.1 billion would be lower. But I do think that the results of all of these reforms is going to be, as Congresswoman Kennelly was indicating, that spending is going to be cut somewhere.

I happen to think that is a good thing because I think the combination of Federal, State, and local spending is too large—together, those add up to 45 cents on the dollar of every dollar anybody earns. So I think the overall thrust here is in the right direction.

If the States are left free to manage their own affairs, I also think there is going to be some savings that would further cut into that $3.1 billion figure. But if—you know, if that kind of program went through that had that kind of impact on Pennsylvania, I have got to think that the Federal Government would be a whole lot less big and that would be saving Pennsylvania taxpayers Federal dollars.

Mr. COYNE. Thank you.

Chairman ARCHER. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. And thank you, Governor Weld, for being here.

My personal view of the Contract With America is that we are attempting to restore States rights, and to a great extent we will free people from the slavery of the Federal Government. I regret that Governor Dean had to leave because I wanted to refer to my State Governor, Governor Zell Miller who is a Democrat; and to give you a little indication of how Governor Miller and I have had occasions to get along in the last few years. I was told that Governor Miller made the comment that when the only thing worse than Mac Collins being elected to Congress is that if he had been reelected to the Georgia State Senate.

Now, having said that, just being in the company of Governor Miller about 1 month ago, he came up to me and said, Mac, as far as welfare is concerned, send me the money, even if you have to send me less, I will take care of welfare. And as a feather in his cap, he has done a great deal of work in that area.

We passed a requirement for work in Georgia. They are now implementing a new program, a program that will instruct caseworkers to figure out which welfare applicants need to avoid assistance rather than trying to figure out how much assistance they can obtain.

Also, the gentleman from New York, Mr. Rangel, made a very good comment about jobs. I personally think you must have a JOBS program to parallel welfare reform or welfare reform will not be successful. And that to me, again, is why the Contract has reductions or credits for families, it will help stimulate the cash flow of the private sector, it has incentives for people who want to invest and take that risk that results in creating jobs. I think both of those have to go together for us to have successful reform.

I would hope that we could include—it was referred to earlier about waivers for Medicaid so that we can revisit the institutionalization of seniors. Now Medicaid requires that many States without the waivers have to put those people into nursing homes rather than looking at other types of settings such as personal home care.

If you would, in the last closing seconds, comment on that Medicaid waiver. Thank you.

Governor WELD. Well, Mr. Congressman, I have had applications for waivers pending with the Department of Health and Human Services for well over 1 year now. We have not been able to implement our reforms in the absence of that waiver authority being granted from HCFA. It has been frustrating.

We think it is costing us money and that our population has not been well served. This is not a frustration that has been limited to Democratic administrations. It has something to do with the relationship between the Federal Government and the States, not with being a Republican or a Democrat. And generally our position as Governors has been not only that we want you to give us the waivers automatically, but that we don't want to have to ask. So we are talking about shared power as well as just shared responsibility.

Mr. COLLINS. Thank you very much for being here.

Thank you, Mr. Chairman.

Chairman ARCHER. Governor, we hear you.

Mr. Levin.

Mr. LEVIN. Thank you, Governor. I think your plea for boldness is attractive, striking while the iron is hot, but I think we have to ask ourselves what and who is going to get burned. So let me ask you about that as someone who is very much in favor of more State flexibility but has some concerns about the extent, I don't want to say extreme, to which you would carry us.

Do you favor block granting in nutrition, the food programs, the same way you state you would block grant welfare?

Governor WELD. I do, Mr. Congressman. I favor local State option in that area. I would mention that Massachusetts fully funds the WIC program and we are great believers in prevention spending in the human service area, so it probably wouldn't make any difference to us, we would be fully funding all those programs.

Mr. LEVIN. The nutrition programs, food stamps, for example, act as substantial economic stabilizers. And you say you are willing to forgo that. Do you have any idea if the block grant had been in place, say the last 7 or 8 years, both in welfare and in nutrition food programs, what would have been the lowered return to Massachusetts?

Governor WELD. I do not know the dollar figure, Mr. Congressman, but I think my answer would be the same as what my answer to Mrs. Kennelly's question would have been: What do you do when a recession comes? And my answer is that the States would adjust their spending to make sure that people were not left to starve on the grates.

Perhaps the money would come from highway programs, perhaps it would come from some other area, but no chief executive of a State is going to put up with breadlines in his or her State. So I don't know where the money would come from but I just—I assert it but I can't prove it, but I assert that Governors would manage to the situation and manage to the figure.

Mr. LEVIN. Let me send you the figures. We may have them tomorrow. I think you are talking about hundreds of millions of dollars for Massachusetts and I think in terms of Federal-State relationships, they have been shaped not only by the civil liberties issues of the sixties, but the economic issues that began to loom large in the thirties.

And we are going to have to act on this and I would like to send you the figures on what these programs have meant for Massachusetts the last decade in food programs, and in welfare. I would be interested to hear what you would cut in your State rather specifically if these programs were cut rather substantially.

Governor WELD. I would be very happy to respond to that, Mr. Chairman. Let me just say, we passed an education bill in 1993 that requires me to come up with a quarter of a billion dollars every year in additional K through 12 education spending. That is putting a lot of pressure elsewhere on the budget, but we are managing to it and if something happened that put a $200 million a year pressure on my human services area, I am confident that we could manage to it.

Mr. LEVIN. Thank you.

Chairman ARCHER. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

Governor, welcome. I have been delighted at your candid testimony. And I wanted to follow through on a couple of the concepts we have been outlining here today. I think there are a lot of us that feel that one of the capstones of welfare reform at the local level is linking welfare rights to responsible behavior. That takes a number of different forms, perhaps a workfare provision that would require people who are able bodied to work for their benefits, a learnfare that would require school-age recipients to attend class, the possibility of some sort of drug testing and also some form of wedfare to discourage illegitimacy.

These have all been talked about at the State level and are now being contemplated at the Federal level, along with policies that reduce dependency, possibly more expanded or more targeted job training programs, or even an extension of health care benefits to recipients who leave welfare voluntarily and who take low-paying jobs without benefits.

With those perspectives in mind, are these the sorts of policies best implemented at the local level with block grants at the Federal level? And are these the sorts of things where States have a broad ability to develop innovative individual approaches targeted to the specific welfare problems in their States?

Governor WELD. I think the answer is yes, Mr. Congressman, conditions do differ from State to State. If you look at the work done by Governor Thompson in Wisconsin, it has been great for Wisconsin. He has been reducing his welfare rolls. It might not apply in some other State.

I am in favor of giving the States the ability to experiment here. I personally would jump all over the workfare and learnfare approaches. I think that is exactly the way to go. I might put a little bit less emphasis on job training programs than another Governor might because I happen to believe there is no substitute for work, not preparing for work. Not thinking about work, nothing except work itself.

And I think if you get somebody having the experience of leaving the house every day and going to work, even if it is 25 hours a week, then they get a supervisor who can give them a reference, they get work habits, I think that is more important than two or three training programs at the end of which you might not find the job you wanted.

Some other Governor might do it differently.

Mr. ENGLISH. That leads me to my followup question. Secretary Shalala was in the other day and was stressing the need to include job training at the front end as a part of any Federal welfare reform proposal. From your experience, how effective have the job training programs been at the grassroots level aimed at bringing people off of welfare.

Governor WELD. I am probably not a very good person to ask, Mr. Congressman, because, as I say, I am more of a believer of getting people into the work experience than putting an enormous amount of money into job training. I would be paying someone for every hour they worked in that community service job whether it was lifting crates in a food pantry or working at a hospital or environmental organization. I think we could get a lot of good done there and I think that is a form of job training. I think a job is the best job training.

Mr. ENGLISH. Thank you, Governor.

Thank you, Mr. Chairman.

Chairman ARCHER. Mr. Ensign.

Mr. ENSIGN. Thank you, Mr. Chairman.

Governor Weld, you weren't here when we first talked about the differences. Some people are opposed to having the flexibility in the States because they say, for instance, like Wisconsin has a more generous provision that is more people move to Wisconsin to receive those benefits and some people are opposed to that because they say it is not right for people to be able—to move from State to State to receive those provisions.

I would like your comments on right now in your State, you are cutting taxes, you are doing some things to make it more friendly for businesses to move to your State. Why should it be OK or encouraged for States to have a more business-friendly climate to attract people because they want to do that and yet not have the freedom and the flexibility to design their publicly funded programs, you know, to the poor or disadvantaged to make their States either less or more attractive to those types of people.

Governor WELD. I agree with the premise of your question, Mr. Congressman. I think States absolutely should have the flexibility to set their own policies even if that means they wind up competing with each other. Besides it is already the case that States have different benefit levels.

I think if I had a completely free hand, I would probably try to steer my State in the direction of social policies more like New Hampshire which is a, relatively speaking, low service/low benefit State. Massachusetts, historically, has been a high service/high benefit State, and I am putting my shoulder against the wheel trying to reverse that a little bit. But I could never get it as far as New Hampshire and that is because States make cultural choices—that is part of the richness of our pluralism. So I think you can't really argue that the States should not have the freedom to compete with each other.

Mr. ENSIGN. The followup question is: We have also heard some talk and, as a matter of fact, Representative Gephardt was here the other day talking about he would like to see incentives built into the system. You mentioned incentives built into the system where if—on a results type of thing where, if States did better, they got more money, but he did not mention the same way in a marketplace where businesses have incentives, they make more money if they do things right but they also are penalized if they do the wrong things.

How do you feel the Governors, including yourself, would respond to penalties and less money in their block grant programs if they didn't meet the results?

Governor WELD. That is the real world. That would be just fine. The example I gave earlier, my hypothetical example of myself failing to put in an anti-illegitimacy policy and therefore losing money, that was a penalty. It contemplates penalties as well as incentives.

Mr. ENSIGN. Thank you.

And thank you, Mr. Chairman.

Chairman ARCHER. Dr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman. Governor Weld, could you tell me, do you budget on a 1-year basis or 2?

Governor WELD. One-year basis.

Mr. MCDERMOTT. So you were $13 billion when you came in and you are now 16?

Governor WELD. $16 and change, yes.

Mr. MCDERMOTT. So you are going up.

I had the experience in 1981 when we went through this block grant business once before, I was the Ways and Means chairman at the State level. We had a Republican Governor who was out in 4 years as a result of it. I want to ask you some questions about it.

If the proposal that is in the Human or the Personal Responsibility Act, which I guess you are signing off on today, you like what they have dropped in as the proposal for the Congress; is that correct?

Governor WELD. I support the Contract, yes.

Mr. MCDERMOTT. You do. You support the Personal Responsibility Act that has the welfare reform bill?

Governor WELD. Generally, yes, Mr. Congressman.

Mr. MCDERMOTT. Well, then, I will just tell you that in 1987, if you had had this act in place, today in 1993, you would have $111 million less in your welfare program. There would be a 30-percent reduction because they allow you to go up 3 percent a year, no matter what happens in the economy.

So now I know you are building your budget for this year and I want to hear you tell the Congress what you are building in as your assumption in your fiscal year 1996 budget that you are going to get from the Federal Government for welfare. Are you expecting the same amount or are you building in a 10-percent reduction or a 20-percent reduction?

What are you submitting to the Massachusetts Assembly?

Governor WELD. It is a slight reduction, Mr. Congressman. I think from about $820 million down to $785 million for the State's share, so that might be a couple of more million reduction.

Mr. MCDERMOTT. So that is about a 3-, 4-, 5-percent reduction?

Governor WELD. Oh, no. More——

Mr. MCDERMOTT. Ten percent.

Governor WELD. Between 5 and 10, closer to 5.

Mr. MCDERMOTT. So you are saying you are going to accept from us a 10-percent reduction at the Federal level?

Governor WELD. Yes. It is not because I am being generous, it is because I am projecting an impact on the caseload from all of these welfare reforms we are trying to get through.

Mr. MCDERMOTT. And you are sure that is all going to be coming out of the Congress, 10 percent, if we cut——

Governor WELD. The way the system is currently configured, I am a 50 percent State. I can look for 50 percent of what I have spent.

Mr. McDERMOTT. Now, if you went into a recession and you suddenly had a large increase in your caseload, how would you deal with that, raise taxes? Or cut benefits? Or what would be your proposal to your legislature since you are not going to have any kind of entitlement out of this place? You will get a capped amount, that is it, go down the road and fix it.

Governor WELD. In a program that was not an entitlement, I wouldn't rule out benefit cutting. I wouldn't rule out going to my highway spending for $100 million or some other part of the budget. I would manage to the figure and, you know, keep an eye on what is happening out there on the pavement. Are people suffering pain, like any Governor——

Mr. McDERMOTT. Would you tighten your qualifications and put people off the program.

Governor WELD. Oh, yes. When we abolished the State welfare program and imposed a screen, a million dollar screen for this program for the disabled, 20 percent of the people on the program did not bother to reapply. Our former program—these eligibilities are not cast in stone.

Our former program made all ex-convicts eligible for welfare. The theory was, you go back to a life of crime if the taxpayers don't support you. That is ludicrous. It made substance abusers eligible for welfare. It made me eligible for welfare.

Mr. McDERMOTT. How about children of women under 18? Do you agree with this proposal that says you can't use any Federal money for women under the age of 18 for their children?

Governor WELD. There are a couple of things there that I would like to think about and I would favor, personally, the State option.

Mr. McDERMOTT. Tell them they are going to write the bill very shortly.

Mr. SHAW. If the gentleman would yield, it does not say that.

Mr. McDERMOTT. I want to find out——

Governor WELD. Two of the provisions that have gotten a lot of discussion in the media, the legal aliens and the children—illegitimate children born to unwed mothers under 18, I would favor State option. I think in my State, I would pick up the legal aliens and I would get the money, somehow.

Mr. McDERMOTT. So you would pick up the legal aliens but not the children of women under 18.

Governor WELD. I am thinking about the second one. I have made a decision on the first one.

Mr. McDERMOTT. Have you any proposal for forcing these young women to go home, to make them go home so that the children have food to eat or are you expecting to pick them up in the CPS, the child protective services.

Governor WELD. My welfare proposal at the State level would require young mothers under 18 to live at home, to live at home at least until they finished high school unless there was an at-risk situation that they were in some physical danger. And in which case, I would not take the child and put them in an orphanage, but I would put the mother and child in a group setting, supervised.

Mr. CRANE [presiding]. The time of the gentleman has expired. Mr. Christensen is next.

Mr. CHRISTENSEN. Thank you, Mr. Chairman. Thank you Governor Weld for your testimony today.

In Michigan, Governor Engler's plan cut property taxes and made up the revenue shortage by raising sales taxes by 2 cents. I did think it was from 4 to 6 cents. In a low population State like Nebraska, if we wanted to do that same thing, we would have to raise our sales tax, I think, up by 12.5 cents.

What recommendations might you have for low population States if they wanted to emulate what you have done in Massachusetts and what Governor Engler did in Michigan? What could we do to make up that revenue shortage if we didn't want to raise sales tax by that amount?

Governor WELD. Well, I can't talk about raising any taxes, Mr. Congressman, because I have taken a blood oath never to permit any tax to be raised in my State. So I have a hard time even wrapping my tiny mind around the concept of a tax increase.

Mr. CHRISTENSEN. Any suggestions as far as what Governor Engler did in Michigan and how low population States, though, because we only have 1.5 million, 1.6 million people, the percentage in sales tax would go up enormously in Nebraska. Are there any alternatives to that or not?

Governor WELD. I really don't think I am competent to answer the question.

Mr. CHRISTENSEN. OK. Thank you.

Chairman ARCHER. Next, Mr. Kleczka.

Mr. KLECZKA. Thank you, Mr. Chairman.

Governor, I was interested in your comments on some proposed changes to the SSI program and I approached the two mayors unknowingly who are members of our next panel asking if they are members of your staff. They indicated they were not—I apologize to both you gentlemen, but I did find a person I think and I would appreciate if you could share with me a copy of your proposal on the SSI program.

Two short questions, Governor. You do support in your statement and verbally the three-fifths majority or supermajority to raising taxes as part of the constitutional amendment on a balanced budget? I am assuming that is correct.

Governor WELD. That is correct, Mr. Congressman.

Mr. KLECZKA. Do you have that provision in your State?

Governor WELD. We do not. I would love to have it.

Mr. KLECZKA. Have you proposed such to the legislature?

Governor WELD. Three years ago, yes.

Mr. KLECZKA. Second, as the balanced budget amendment moves forward, it does not contain a provision on mandates, on the Federal Government paying for mandates to State government.

Would you be supportive of that protective language in the constitutional amendment?

Governor WELD. Well, yes, I would, but my understanding that there might be a couple more votes for the balanced budget amendment in an adorned form, and I think the most important thing is to get the balanced budget amendment through, particularly if we can get that antiunfunded mandates language through in statutory form. That is enough protection for the short term, and we have been assured by leadership that there will be at least a vote on the

Hill on the antiunfunded mandates language in the context of a constitutional amendment at some point this year.

I think it might be better if you let the balanced budget amendment go through and then let a few months go by so that support for the antiunfunded mandates concept could bubble up to Washington from the State legislatures and then maybe you get them both which is the best long-term situation.

Mr. KLECZKA. But it has to bubble here first, but it bubbles up in the States if it is not the part of the proposition we send to the States——

Governor WELD. What I mean is if there is a delay, and this is conjecture on my part, but if there is a delay, then you might get the State legislatures calling up their Congressmen saying, hey, we think a yes vote on this antiunfunded mandates constitutional amendment would be a handy idea.

Mr. KLECZKA. Well, I think it is going to be a handy idea and I think that bubble up should start with the Governors who are supportive, generally, of the balanced budget amendment. As a State—former State legislator and most of the members of the panel are, I recall some years back on the CETA program and the State of the Wisconsin where I hail from did participate in the CETA program, and then finally at the end of the Federal funding portion, we read the fine print and we were under a moral obligation in Wisconsin to retain these folks. And we scrambled around and we finally did so but at the expense of some extreme budget pressure.

Let me say before my time expires that without this protection for the States in the balanced budget amendment itself, and with the pressures to cut over $1 trillion between now and 2002, don't think for a moment that block grants, be it for welfare or any other program, are going to be sacrosanct.

We are going to be looking at those in cuts so, in essence, what we are going to be doing in a Federal level, we are going to be very heroic at home but we are going to constitutionally shift the shaft to you, the Governors, and that 6 years down the pike we won't know whether or not I am correct as we sit here. Chances are you probably won't be in the Governor's seat anymore, but I pity your successor because, at that point, the pressures are going to be on the States which have clearly limited resources. And as Governor Dean said, they have to go right to the middle-income taxpayer if in fact those adjustments are made through tax increases.

One point that hasn't been brought up in the committee is another item in the Contract calling for a little checkoff box on the tax return. If you or I check that off, that means 10 percent of our tax payment to the District of Columbia would go for budget deficit reduction only and if every taxfiler in the country checked that box, that is 10 percent less revenue that we are going to have to send back to you to pay for the things that we are mandating—not mandating, that are left to you in your State.

Governor WELD. That would be wonderful. Drive down the cost of capital, we would be able to do better than the Germans and Japanese. That would be terrific.

Chairman ARCHER. The time of the gentleman has expired.

Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman.

You know, frankly, Governor Weld, I am very impressed with your testimony on this committee.

You know, we can talk about training people after they get out of school. We are talking about training people and finding them jobs. In my judgment, that starts way back, in fact it starts in the grade schools and kindergartens as we go along.

When I hear some of the things that are being said to me by the outstanding congressional students that come up to Washington, I ask them what they are being taught in public education. They are not being taught that you stand on your own two feet. They are being taught, well, the government is the answer.

Now, is there some way that we can, or should we or shouldn't we, start looking at what we are teaching our young people now about what has made this country great rather than waiting until they have been indoctrinated with the social welfare programs when they get out of school.

I would like to have your opinion on what we are teaching in the schools and public education now.

Governor WELD. I think, Mr. Congressman, probably we should move a little bit in the direction of the German apprenticeship program. We have introduced a bill in our State actually which has gone through to create a certificate of initial mastery in the 10th grade.

And, you know, in the past, our education system has been seemingly designed on the assumption everybody is going to go to Ivy League schools. That ain't true. Fifty percent of our people aren't going on to college at all. And I think we need more emphasis on vocational and technical education and realize the facts, that not everybody is going to go on to the liberal arts, bachelor's degree. And I think we would be doing everybody a favor if we moved in that direction.

Mr. HANCOCK. In other words, your opinion is that, let's teach them that even school itself is work; am I correct in that?

Governor WELD. That even?

Mr. HANCOCK. That even going to school itself is work, it isn't just fun and games.

Governor WELD. That is right.

Mr. HANCOCK. In other words, your position is that we need to get people interested in work of some type?

Governor WELD. That is right. I don't think we are doing enough specific preparation during school for vocational and technical education, and I think our school-to-work programs are nowhere near focused enough. We have got to go to the business community and say, what do you need in terms of people coming out of school, and let the businesses—the employers—design the school programs. You have got to get more business input into the curriculum in the schools.

Mr. HANCOCK. Real quickly, what is your opinion of "outcome-based education" that is being pushed so hard through the National Education Association?

Governor WELD. Well, I know that outcome basing has got a bad aroma in the education area. I use it in a lot of other areas measuring by results as opposed to measuring the process, so I think maybe I don't really understand enough what outcome-based education means.

Mr. HANCOCK. Thank you, Mr. Chairman.

Mr. CRANE. The time of the gentleman has expired.

Mr. Portman.

Mr. PORTMAN. Thank you, Mr. Chairman. And I thank Governor Weld for being here today. Good testimony.

I also want to thank you for being an active participant in the new partnership we have been trying to develop in the past couple of months between the legislative branch at the Federal level and the Governors.

I want to thank you on the unfunded mandates front. You have been very helpful, as have your staff, in putting together a good piece of legislation. As you know, the Governors helped write H.R. 5. It is expected to be on the House floor next week. My understanding is it may go to the Senate floor as soon as this afternoon.

I enjoyed your dialog with Mr. Kleczka. I am glad to hear he is interested in this issue, the unfunded mandates. I look forward to having him as cosponsor on the bill. It is a good strong first system on the unfunded mandates front and, again, it was not something that was done solely within the halls of this Congress, it is something where we reached out to the Governors and local officials. And, again, I want to thank you for helping us on that.

I think it will lead to a new partnership. I think it will give many of the State legislatures comfort as to the unfunded mandates part of a balanced budget amendment. If in fact it is necessary to go back later and do an unfunded mandates amendment, I am sure that you and others will be supportive of that. Our leadership has indicated there will be a vote on that.

During your testimony, I had one question with regard to Medicaid. I was struck by your success there in terms of managed care. I think in the New York Times today there was an article on managed care and Medicare, something this committee is extremely interested in.

I guess, if possible, I would like for you to elaborate a little more on what you see as the advantages to the managed care approach in Medicaid. And then if you could comment on what else we could do at the Federal level in terms of making your life easier on the Medicare front. This is an area that is not often talked about in the welfare context but obviously is one, if not the, biggest program.

Governor WELD. The proof of the pudding is in the eating, Mr. Congressman, and I think during the 4 years prior to your coming in in Massachusetts the annual growth in Medicaid was something like 18 to 52 percent a year. And now in the last 4 years, we have gotten the growth down to under 3 percent. When you factor in an increasing caseload, it is negative growth last year. So the managed care aspect there has been terribly, terribly important.

Mr. PORTMAN. You talk about the caseload having increased and yet you are seeing reductions in cost because of the cost efficiencies in managed care?

Governor WELD. Right. And another thing we have done is reform our hospital financing system at the State level in 1991 to permit managed competition and bulk purchases and having the players in the health care industry use their purchasing power, their buying power to get volume discounts and drive down costs. I think that this has also had a big impact on costs in that area, letting the market work.

It is a good case study for introducing a market mechanism into the provision of the health care where it did not exist before and having the market drive costs down.

Mr. PORTMAN. With regard to Medicaid, just briefly, what else would you look for from the Federal Government? What other flexibility or what other Federal approaches on the Medicaid front could keep your costs down?

Governor WELD. Well, of course having to go to Washington to get permission for every amendment to the State plan slows us down a lot and I think deprives us of the flexibility to keep our costs down by just such initiatives as I mentioned. We needed that waiver for that hospital financing measure back in 1991. We got it, but I have got a bunch of others pending.

Mr. PORTMAN. Thank you.

Mr. CRANE. The time of the gentleman has expired.

Mr. Payne.

Mr. PAYNE. Thank you very much, Mr. Chairman. And Governor Weld, welcome, and thank you very much for your testimony.

I want to spend my couple of minutes here talking a little bit about welfare reform and specifically the block grant proposal. Governor Dean said, on behalf of the National Governors' Association, that the Governors were in favor of the block grant proposal and said the NGA thought that there should be some kind of minimum standards that would be set in terms of the block grant funds.

Would you comment on what you think the minimum standards programs ought to be in terms of any kind of block grant funding?

Governor WELD. Well, I think Governors certainly agree with the idea, for example, of a work requirement and of time-limited benefits. The question becomes whether you are going to make that a requirement of the program or whether you are going to make it a goal of the program with the Federal Government performing an assessment to see how well the States are doing in reaching those goals would then either benefit or penalize depending on how well individual States were doing.

I think Governor Dean and some others would prefer that those principles be conditions to receipt of the money. I would prefer to have a single Federal audit every year, with an assessment based on that audit rather than on receipt of the funds because the latter could contribute to the sort of micromanagement that we have seen in the past. You might start out with 4 or 6 conditions, then pretty soon there would be 18 conditions and we would be back where we were before I acknowledge your duty to follow the money and make sure it is being spent on what it purports to be spent on.

Mr. PAYNE. Let's see if I understand. So you are saying, then, that there would be no minimum conditions but yet there would be certain parameters. What is it exactly you audit as you audit each year if there were no standards to which you audit?

Governor WELD. Well, you would have your goals that the States were to achieve and you could design the audit any way you want. But the example I gave earlier is, let's suppose that one of the Federal standards or goals or even conditions was measures to reduce teenage illegitimacy.

Let's say I did a lousy job in my State and that my teenage illegitimacy rate was triple what it was anywhere else. I would expect Uncle Sam might want to take some action based on that. That is what I call a tripwire, but I like to build those tripwires into the future rather than having them all be at the starting gate and have the States have to step over the tripwires in order to participate in the program.

Mr. PAYNE. OK. So you are saying then there ought to be goals such as reducing teenage illegitimacy but there should be no specific goals or no specific requirements in terms of how much needs to be done in order to meet them.

Governor WELD. I think you can build how much needs to be done into the future. I am a little hesitant about saying that Governors would like to sign up for these 12 conditions on the program as a condition of receiving any money to begin with because then I am afraid that could lead you to management by the bureaucracy, not even by the committees of Congress but by the administrative bureaucracy. And management by a bureaucracy too often turns into micromanagement, what we don't want.

Mr. PAYNE. It seems the audit processes lead or potentially could lead to even more management by bureaucracy.

Governor WELD. Well, except that an audit can be an audit on a test basis. I think you are more than entitled to that. I don't know of any Governor who would say, give us the money and don't audit how it is being spent.

Mr. PAYNE. Well, I am not suggesting we ought to do that. I am just asking about what the rate ought to be and what the minimum level ought to be. And I think what you have said is we should have goals, we should perhaps have minimum standards and then there should be some incentives and disincentives to encourage reaching those goals.

Governor WELD. Right. Goals and assessment mechanisms is how I would describe it, Mr. Congressman.

Mr. CRANE. The time of the gentleman has expired.

Mr. Shaw.

Mr. SHAW. Thank you, Mr. Chairman. I would like to follow up on what Mr. Payne was talking about because, Governor, we had this conversation about 1 week ago. I think it was pretty much the consensus that we could put in place a mechanism for a preapproved plan which would be voluntary on the State's part if the State believes it is getting into an area it is concerned about and feels that it should have some preapproved mechanism that would be available to the State.

But the audit would of course have to go forward and, it being Federal money, the Governors certainly recognize the need for that. I think what we would try to do is to set up a the basic framework, which would be just as simplistic as we can possibly make it and as direct as we can possibly make it and easily understood and difficult to manipulate by the bureaucrats, so that people will know where they are going. We should get the Governors to help us draw it.

I can tell you that Congress has really reached out to them, Democratic and Republican Governors. And I mentioned this to Governor Dean as he was leaving in order to give us your input on drawing this plan because we want it to work. We want to decrease the bureaucracy.

Governor Weld, I very much appreciate the tremendous help you have been in these meetings in keeping things on an even keel and recognizing the progress that we have been making in meeting with the Governors. You have certainly brought great pride upon your own administration, yourself and your State in taking a collapsed miracle, resurrecting it like a phoenix coming out of the ashes and you have done a wonderful job for Massachusetts. You put together just some good commonsense programs and some good commonsense tax structures which have brought your great State back.

And it is certainly recognized, I think, by us in Washington, and it is also a model, not only of what you have done with welfare, but also the tax policy that you have put in place. It just makes common sense what you have done and the results have been terrific.

I just have one question that I do want to ask you. Have you seen any of the welfare benefits being cut off? Have you seen this come into play in any of your crime statistics?

Governor WELD. Welfare benefits being cut off?

Mr. SHAW. Yes.

Governor WELD. Contributing to crime?

Mr. SHAW. Has there been any correlation between cutting the benefits and the crime rate within the State?

Governor WELD. Well, our crime rate is down a little bit over the last few years and that follows the time when we cut off a lot of the State welfare benefits specifically for ex-convicts. So that would suggest a lack of correlation.

Mr. SHAW. Good. Well that question has been raised on several occasions and I appreciate your being able to give us that information. Thank you very much for being with us today and the contributions that you continue to make toward welfare reform.

Governor WELD. Thank you, Mr. Chairman.

Mr. CRANE. Mr. Neal.

Mr. NEAL. Thank you very much, Mr. Chairman.

I want to welcome you my friend.

Governor WELD. Thank you, Congressman.

Mr. NEAL. You know I served as mayor and don't ever take credit in an executive capacity for crime standards going up or down because surely it is going to be reversed at some time and your opponent will remind you of the previous position that you took.

Governor WELD. With any luck, I will be one jump ahead of the posse, Mr. Congressman.

Mr. NEAL. I want to welcome Governor Weld, as you can see very affable and very likable. In a State that is overwhelmingly Democratic, he has enjoyed great success in the polls, great speculation about his national ambitions. He was over in Ireland recently trooping around. He is running and we do want to welcome him here in that spirit.

One of the things I am struck by, you said you cut taxes nine times and you said you needed a three-fifths majority in the State constitution to prevent that from happening.

Governor WELD. Oh, no. Only on the up side. I wouldn't apply the three-fifths to a tax decrease and I don't think the house provision does either.

Mr. NEAL. One of the esteemed sons of Massachusetts, Elliott Richardson, I think that you would say he should share that title, has suggested that one of the relics of the past that ought to be abandoned here in the Senate of the United States is the filibuster. Why would we move down the road of creating a majority here when 40 percent plus one of the elected Members of the Congress can hold up what may well be for whatever may be sound policy and strong principle?

Governor WELD. I think anybody that creates downward pressure on taxes is good, just like I am about to go into another committee and testify in favor of the line item veto which I like because it creates downward pressure on the budget.

Mr. NEAL. You have worked with a legislature that is overwhelmingly Democratic, the leadership on both sides. You haven't had to resort to that sort of a tactic.

Governor WELD. That is true, Mr. Congressman. But I think we have been lucky in that we were able to achieve more in a down market because everybody was scared of our State going into bankruptcy than we would have in more normal times.

Mr. NEAL. Let me just close on this note. Let me just ask you a question and it will be between you and me as they say here in Washington.

Governor WELD. OK.

Mr. NEAL. Do you have any plans to send back any of that $11 billion that is going to the Boston Harbor in the spirit of this tax cutting zeal?

Governor WELD. I think the Federal money is going to the artery tunnel project and we are in the middle of a stream there, so I don't think I want to change horses on that. I have said that I am not going to come looking for any more money on the strength of any change in the project. It is time to cap the Federal investment there.

Mr. NEAL. At $11 billion, there is no more to come back and get.

Governor WELD. Seven seven. Seven seven and change.

Mr. NEAL. Thank you, Governor. It is nice to have you here.

Mr. CRANE. Well, I want to express a profound appreciation to you, Mr. Governor, for more things than I can attempt to convey today, but you have performed a near miracle in what was known as Taxachusetts. And going back to that 1980 campaign traveling in your neighboring State now governed by Mr. Dean, I remember that I encountered many Massachusetts—former Massachusetts citizens who had jumped that line to get away from the excessive rates of taxation there, and it is really a distinguished record. And when you need help in Illinois, please let me know because I owe you one, Bill.

Thank you so much.

Governor WELD. Thank you, Mr. Congressman, and I wish you would run for President again.

Mr. CRANE. Mayor Goldsmith and Mayor Rendell, are they here? Please be seated, gentleman. And before we proceed, I have a unanimous consent request from our colleague who is unable to be with us at the moment, Mr. Jacobs from Indiana, welcoming Mayor Goldsmith to the committee, but we have also our distinguished colleague from Indiana, Danny Burton, who is here. And Danny will you please introduce the mayor.

Mr. BURTON. I thank you, Mr. Chairman. You never know about political aspirations but Mr. Chairman, we also have Congressman Buyer here from Indiana, the great new Congressman, second-term Congressman who will also share in introducing our great mayor from the city of Indianapolis.

Mayor Goldsmith was elected prosecutor many years ago and did an exemplary job as the prosecutor in dealing with the severe criminal problems we had in Indianapolis. And in 1991, he was elected mayor. He has been very, very active and a leader in downsizing government. He is making government much more responsive to the people of Indianapolis than has been the case in the past and he has done it while holding the line on taxes.

As a matter of fact, some of his accomplishments since he became mayor, he has reduced the city work force by one-third, by about 35 percent. Now bear in mind there has been no tax increases and he has reduced the work force by 35 percent. At the same time, he added 100 additional police officers to help in law enforcement. He achieved $100 million in savings by inserting competition into delivering city services and he has privatized many parts of the city government. I am very interested in golf, as many of my colleagues know, and he has privatized many of the city golf courses and they are much better than they were in the past because of that privatization effort.

We have had 6 years without a tax increase. Three years of record job growth. And he has invested $500 million in infrastructure improvement and all the time while holding the line on taxes. I think he is one of the great mayors of America and I am very proud he is my mayor and I am very proud to have been able to be a participant in introducing him here today.

Mr. CRANE. Thank you.

Congressman Buyer.

Mr. BUYER. Thank you, Mr. Chairman, I would like to commend Mayor Goldsmith for his effective leadership in regard to urban renewal in the city of Indianapolis. Mayor Goldsmith has taken a lead in the city of Indianapolis in terms of streamlining and reorganizing government, by using the practical methods of government that are efficient and cost effective.

Mayor Goldsmith has achieved these things again, exactly as my colleague said, without raising taxes. We here in the Congress should listen well to Mayor Goldsmith in his leadership in reforming government and his innovation, not only with his background with crime, but with welfare reform that we are talking about in giving flexibility to the States and its impact with the cities.

So I welcome Mayor Goldsmith here to the Congress and to this committee and thank you, Mr. Chairman.

Mr. CRANE. Thank you for your introductions. And now, honorable mayors, if you will proceed with your opening statements. And we have some time constraints, so if you have a lengthier than 5-minute presentation initially, be assured that it will be a part of the record and proceed.

STATEMENT OF HON. STEPHEN GOLDSMITH, MAYOR, CITY OF INDIANAPOLIS, IND.

Mr. GOLDSMITH. Thank you. I don't have longer than a 5-minute presentation to begin with. Let me just say briefly I appreciate the Congressmen's introductions.

Indianapolis is the 12th largest city in the country. We have one of the best economies. We also have all the same problems that everyone else does. This Congress has obviously a historic opportunity and that is to face up to the fact that the previous Federal policies have aggravated the problems in cities. They haven't mitigated those problems. And there will be a temptation just to walk away from cities and say three decades or two decades of failed Federal policy, we will just eliminate those policies and ignore cities.

I would hope you would resist that temptation and look at cities as great places and how a renewed relationship between the Federal Government and city governments around the Contract With America can produce a better economy in our cities.

Let me just say very briefly that our marketplace has changed. All of us who are in urban corridors see a situation where if you look on the other side of the cityline, the crime is less, the schools often are better and the tax rates are less. And with the aggravation of the Federal mandates and the welfare system, we really are seeing structural disinvestment with dollars, private dollars kind of rolling out of cities. And the issue is how to use tax policies to encourage investment in our cities.

These ever-growing concentric circles of poverty threaten not only the people who are in them but they also threaten the suburbs as well. We have to find a way to have wealth increase so these increasing circles of hopelessness and poverty and crime can be reduced and I think we have a historic opportunity to do that.

Frankly, my city is succeeding despite Washington, not because of it. Washington's policies, dysfunctional welfare systems, ill-advised mandates, have made it more difficult for me to succeed.

My proposition here, Congressman, is three part and very simple and is consistent with the Contract With America. One, wherever you can, will you please use tax policy and not Federal grants to make it a good place to live and work in my community. Second, use the marketplace and not mandates to be a successful partner with cities. And third, use both of these to balance the budget. Very briefly let me mention each.

First, I would hope that you would consider tax policy, not spending, to solve the problems in my city. This Congress obviously appreciates the importance of tax policy. In the Contract With America are very powerful provisions to encourage family formation through credits for children. It encourages investment through capital gains cuts.

That is the same sort of thinking that you are addressing to family structures, using tax credit policy, I would hope that you would use that as an approach to cities. That is to say, stop giving us grants with lots of strings attached which are very expensive and think about ways to use taxation to encourage private investment in job growth much more efficiently than through grants in urban corridors. You can reduce the Federal role in cities and in States by using tax policy and eliminating the way we do things now.

I would—we are not prepared here today to discuss details but if you have a flat tax, make your tax flatter. If you cut capital gains, cut them more aggressively in areas that are poor. If you have a possibility for payroll credits for people who have job locations in urban corridors, all of those are much more powerful and much more wealth producing than the failed welfare policies of the past.

Second, I would encourage you to use markets, not mandates. As we all know in the room today, Liberals and Conservatives, welfare pays more than work. You have destroyed the marketplace in my city by making sure if you don't work, you earn more than if you do work. You have destroyed the marketplace.

I would ask you to consider how to stop this particular addiction and, as we do that, let me just very briefly say that the—as a prosecutor, I collected child support for 12 years and my collections went from $900,000 a year to $38 million a year. The moms I represented were rational people. They knew what was in their best interests. It was not in their best interests to work because welfare paid more than work.

We can create a rational system and I would suggest that just taking the welfare system in toto, using Federal—taking Federal bureaucrats and moving them to State bureaucrats is not the answer. We need to use the marketplace to create jobs, not just to move the Federal welfare system to the State. And there are some ways to do that.

Finally, I would just ask that you free us from these mandates. And I could give a long list, but 6 seconds on several. The Fair Labor Standards Act took more police officers off the street than you put on the street last year with the crime bill. The 13(c) of the Mass Transit Act ensures that poor folks can't get to their jobs in an efficient and effective way.

The Davis-Bacon Act, as applied to community block development grant money, makes sure I can't hire urban poor. On and on and on. We have a Tax Code that says you will give me incentives if I have socialism rather than private service delivery and they are many of the areas of privatization that Mayor Rendell and I have done.

Just to conclude, my messages simply are you can balance the budget. You can cash out all your grants. Take all the bureaucrats at the State and Federal level, keep all the benefits, give me some opportunity to make my marketplace work and we will all be better. We reform the welfare system along the same direction.

So my message is please use tax policy. Our marketplace is not even today. The Federal Government has destroyed the marketplace in cities. It is very expensive to invest in our city. Please help us with tax policy, not grant policy, not bureaucracy, not welfare but tax policy to make our marketplace work. Remember that the marketplace works, mandates don't.

And if you could balance the budget around these principles, we will create, I am absolutely convinced and committed to creating, to creating opportunity for poor folks in my community and we can create opportunity through a conservative agenda if we pay attention to those principles and infuse hope and opportunity and jobs in urban corridors.

Thank you very much.

[The prepared statement follows:]

Testimony to the House Ways and Means Committee
Mayor Stephen Goldsmith
January 12, 1995

Mr. Chairman:

Thank you for the opportunity to testify on the Contract with America and think through with you what a new urban agenda for the federal government might look like.

The Republican victory on November 8th was a clear signal that the American people no longer trust big government, particularly a big federal government, to solve their problems.

Many observers expect the 104th Congress to ignore cities; or, worse, to carry out the voters' call for smaller government in ways destructive to urban areas. It would be easy to leave the cities for dead, figuring it is the price they pay for decades of failures by big-government mayors. But as the leaders of this historic Republican Congress, you have the opportunity to do the completely unexpected. You can -- you must -- fashion a positive Republican agenda for America's cities.

The first thing Congress should do is recognize that the marketplace in which cities operate has changed. No longer do major cities compete against each other for businesses and home owners. We compete against our suburbs, and we start out at a substantial disadvantage. Suburbs have lower taxes, lower crime, and better schools. As a result, wealth and jobs are rapidly flowing out of our cities, leaving pockets of poverty behind. Not only has the federal government failed to address this fundamental imbalance, it has actively increased the centrifugal forces pushing wealth out of the cities.

The good news is that there is a new generation of mayors already at work in our cities. The same small government sentiment that drove this year's election has already been making big-city, big-government mayors an endangered species. Taking their place are mayors of both parties who are adopting more conservative approaches. We are holding the line on taxes, reducing the size of our governments, and becoming more responsive to our customers.

Yes, cities are surviving; and some of us are even thriving. In my city, Indianapolis, we have added 15,000 jobs to our economy over the last three years; and the most recent unemployment statistics show us at 3.9% -- as close to full employment as a major city can get.

If the most feared words outside Washington are, "Hi, I'm from the federal government and I'm here to help you," then the most annoying words inside Washington may well be, "Hi, I'm a big-city mayor and I'm here to ask for more money."

You won't hear us asking you for bigger federal checks. For too long, big-city mayors have come to Washington with tin cups out, painting bleak pictures of the despair and hopelessness of their cities, and beseeching you for bigger federal checks to address all the awful problems of life in America's cities.

This "pity strategy" of urban aid must end, today.

Our cities are surviving not because of the federal government, but in spite of it. Federal action, from the Interstate Highway Act to the completely disfunctional welfare system, acts to inhibit the operation of the free marketplace in cities. Yet most cities prosper nonetheless.

Don't misunderstand -- ultimately, cities cannot succeed without your help. But frankly, Washington has been our problem much more often than it's been our partner in attacking urban problems.

The Contract with America is an excellent start. Balancing the budget, reforming welfare, cutting taxes, and reducing the capital gains tax will be helpful to all Americans, including residents of cities.

Here's how to fashion an urban agenda that helps cities, sticks to the principles of the Contract with America, and acts in accordance with the clear will of the people for smaller government:

First, we need you to end federal policies that drive families and businesses out of America's cities. Congress must reform welfare and job training, provide incentives for urban environmental clean-up, remove federal barriers to competing out municipal services, address unfunded mandates, and dismantle the federal grant bureaucracy.

Second, we need some small remedial actions from the federal government to help us overcome 30 years of failed policy. Congress should create a federal tax advantage for families and businesses to invest and locate in cities.

Use tax policy, not grants, to help cities

The Contract with America, with its tax credits for children and its capital gains tax cuts, displays a clear appreciation that tax policy is preferable to federal spending as a tool for helping people. This philosophy extends to cities as well. A series of thoughtful tax incentives could apply a tourniquet to the flow of businesses and families leaving cities, and give cities the time and tax base to address their underlying problems.

If the federal government were to create a federal tax advantage for businesses and families that locate in cities, you would immediately begin to reverse the centrifugal federal policies of the past that forced wealth and jobs out of cities. This tax advantage, if significant enough, would be so valuable to cities that you could eliminate virtually every urban grant program and cities would still come out ahead.

This tax advantage could be structured in any number of ways. Most dramatic would be reducing the federal tax rate by some small amount for residents of cities. This would be particularly simple to accomplish if a flat tax is established.

As the well-respected business journal in my city recently editorialized,

> "[A federal tax break for residents of cities] is an idea that could reduce the cost of assisting cities by reducing the federal bureaucracy, while at the same time giving businesses and families incentives to return to the cities' cores. More people and more commerce would mean more tax revenue, thus offsetting the lost grant money. And, perhaps more importantly, such boosts in population and activity could help stem suburban flight and the risk that cities become cores of poverty ringed by affluent suburbs. It would mean restoring the financial health of cities."

If an across-the-board tax advantage is too ambitious, consider a bonus provision for the planned capital gains tax reduction to reward investment in cities. Or, even better, reduce the payroll tax for companies that locate in urban areas.

Using tax policy instead of grants to allocate assistance to cities would eliminate the overhead of federal and state bureaucracies, and target revenues directly to the areas they are needed most. If you are serious about reducing the size of the federal government, that's one guaranteed way to do it.

If you must use grants, reduce their amounts but increase their flexibility

The bizarre process of navigating the federal bureaucracy for grant money creates crazy side effects. First, federal dollars end up going to the cities with the most clever grant writers, not the cities with the most pressing needs.

Second, federal assistance drives local strategies, as local governments tailor their solutions and even their view of the problems to maximize their ability to obtain grants. If drug treatment is what pays from

Washington this year, you can bet that the need for more drug treatment programs is the need cities will start exhibiting. Disjointed (and sometimes even contradictory) federal programs lead to disjointed, ineffective local strategies, as cities try to mix and match from hundreds of federal programs.

If the federal government were to cut grant funding by, for example, 20% -- but consolidate the grants into only a few general categories, cities will actually receive more dollars because you will cut the overhead rate. Bob Woodson, president of the National Center for Neighborhood Enterprise, estimates that by the time one of the dollars you allocate for antipoverty programs trickles down through federal, state,and local bureaucracies and actually gets into the hands of a real person, only about 33 cents is left.

So reduce the amount you spend on cities by 20%. Consolidate the estimated 600 federal grant programs into just a handful of areas that eliminate federal and state middlemen and give broad discretion to local governments. Clear out some of the thousands of bureaucrats that currently administer these programs. Apply the savings to deficit reduction or other pressing national needs. And the nation's cities will still come out ahead.

Help rebuild the free market in urban neighborhoods

The free market does not exist in the inner cities of America, period. Any attempt to revitalize our cities must begin with this understanding, or it is destined to fail. When welfare pays more than work, when public schools graduate kids that can't read, when crack use creates criminals so irrational that traditional sanctions don't apply, when high taxes and crumbling infrastructure keep businesses away, we cannot delude ourselves that the free market works.

The first order of business if Congress wants to rebuild inner cities, therefore, is to help rebuild the free market. Start by reforming welfare. The welfare system as it has existed for the past two decades has failed. There are all sorts of awful side effects of the welfare system as it currently operates. Pay immediate attention to changing the rules that cause welfare to pay more than work. Folks on welfare, acting very rationally in the best interests of their families, recognize that they will lose money if they enter the workforce. Our local efforts to create markets cannot succeed as long as this is the case.

Any legislation that frees welfare policy from the failed federal bureaucracy would be welcomed by the nation's mayors.

However, with all due respect to some of the extraordinary governors at work in America today, state welfare bureaucracies are only marginally less bad than the federal bureaucracy. A critical ingredient of successful welfare reform is breaking up the existing government monopoly on the delivery of welfare services. No matter what reforms are ultimately enacted, they must be accompanied by reform of the delivery system. We need a competitive, performance-based system, with many different providers. They should be paid based on how many people they get out of the welfare system, not how many people they keep in it.

A useful model is school reform -- government could "charter" local welfare offices, with pay based on performance. This would allow innovative private providers of welfare to exist, take advantage of existing neighborhood-level institutions, and cause existing government welfare offices to produce results or go out of business. A chartered welfare system would allow government to take advantage of churches, not-for-profits, and other neighborhood organizations that are some of the strongest forces for good in urban neighborhoods.

Help level the playing field to attract private investment

Major cities no longer compete against each other for businesses and home owners. We compete against our suburbs, and are losing badly. Suburbs have lower taxes, lower crime, and better schools. As a result, cities are bleeding wealth, population, and jobs. We would much rather have private dollars in the form of new businesses and new middle-class home owners than more taxpayers dollars from you. Help us get them.

First, no federal agency gives less thought to the unintended side effects of its actions than does the Environmental Protection Agency. When the EPA imposes draconian clean-up standards, it effectively quarantines urban sites. No company will build and no bank will lend on a property with even a hint of contamination -- not for fear of the environmental hazard, but for fear of EPA lawyers. Rather than invest in clean-up, businesses and investment find it much easier to leave our cities. Our tax base shrinks, the urban sites never get cleaned up, and the urban poor lose access to good jobs. Everyone loses.

Use Superfund to pay for environmental clean-up, not for lawyers. Use tax policy and government guarantees to encourage companies to clean up and reuse urban sites. You will show that conservatives can have a working approach to urban environmental problems, and as a nice side benefit you will create hundreds of thousands of jobs in cities at the same time.

Free us to spend more money protecting our citizens

Increasingly, the federal government tells cities not only how to spend the federal money we receive, but also how to spend our own local tax dollars. Every time Congress passes a new mandate, it constricts our ability to deal with our own problems and inhibits the functioning of local democracy.

Every day, elected officials make trade-offs between important public goods and referee arguments between interest groups. As citizens of my basketball-savvy state will tell you, the official closest to the action is usually in the best position to make the call. Mandates prevent us from "making the call" on local priorities. We mayors respect the role of Congress in setting a national agenda for America. But give us the authority to pursue that agenda in a way that makes sense for the individual needs of our cities.

The real world effect of ever-increasing federal mandates is that cities have less money to spend on public safety, which for most of us is our number one priority. While the much-vaunted crime bill may have added some number of police officers around the country (Indianapolis got about 29, an increase in our police force of about 2.5 percent), the combined effects of the Clean Water Act, the Clean Air Act, the Americans with Disabilities Act, the Fair Labor Standards Act, and a dozen other major mandates have reduced the number of police officers we can afford by probably ten times that amount. If you really want to fight crime, you don't need to give us more money; just free us to spend more of our own.

Encourage "reinventing government" at the local level

"Reinventing" got its start at the local level because financially-strapped cities knew they could not raise taxes and had no choice but to scour their budgets for savings. Cities discovered that if they allowed private sector companies to compete against government workers for contracts to provide services, the market would create efficiencies and improve service.

Here in Indianapolis, competition helped us save $100 million, reduce the non-public-safety city workforce (everybody but police officers and firefighters) by 30%, and fund a massive $500 million infrastructure improvement program without raising taxes. Not coincidentally, the last three years have been the best in the city's history for job creation. As Indianapolis and scores of other cities have demonstrated, competition works.

There are scores of ways the federal government could help us in these efforts. Let me cite two.

Indianapolis could dramatically improve mass transit by allowing private sector providers to compete against the government-run public transit monopoly. We could improve service, cut costs, and create opportunities for the creation of small- and minority-owned businesses. However, the federal government stipulates that any mass transit worker "negatively impacted" by competition is entitled to six years full salary and benefits as compensation. Michael Jordan didn't have a contract that good. Cut funding for mass transit; but let us break up the mass transit monopoly and purchase transportation from the low-cost provider.

The second example is a remarkable irony. If a city asset such as a building, wastewater treatment plant, or golf course is constructed or improved through proceeds from municipal bonds (as most are), the federal tax code actually punishes us if we allow a private sector company to manage or purchase that asset -- even if the private sector company could manage it better and cheaper for the benefit of taxpayers. In other words, the federal tax code encourages socialism and public ownership over capitalism and public benefit. It should be changed.

A smaller and more conservative federal government can produce a positive agenda for addressing the problems of poverty and hopelessness in America's cities. The new Republican Congress under your leadership has the ability to prove it. Give us more flexibility in how we use federal assistance. Release us from micromanagement through mandates. Level the playing field for private investment. Remember that the marketplace does not work in our inner cities, and help us empower everyone to participate in the mainstream economy that provides most Americans with health, hope, and security. And cities will create their own success without asking you for more federal dollars.

It's a deal Washington can't afford to refuse. Thank you.

Mr. CRANE. Thank you, Mayor Goldsmith.
Mayor Rendell.

STATEMENT OF HON. EDWARD G. RENDELL, MAYOR, CITY OF PHILADELPHIA, PA.

Mr. RENDELL. Thank you, Mr. Chairman. We were told by your staff that pursuant to Speaker Gingrich talking about the cost saving that we have done in Indianapolis and Philadelphia, to relate some of these and how they would possibly be applicable to the Federal Government.

I did that in my written testimony and I am not going to miss the chance of telling the Ways and Means Committee what I think about certain parts of the Contract With America and certain things that I did think are essential to the Federal Government helping cities. And I think Mayor Goldsmith was right on all of those points.

The Contract With America, I think, can be something very positive for cities and for the residents of the cities. There are parts of it that I am extraordinarily enthusiastic about. As you know, all mayors support the portion of the Contract that talks about the elimination of unfunded mandates. I would love to see the waivers that is in the current bill, S. 1, and the bill in the House that extended from a 50-percent vote to waive to the same 60 percent that you are going to require for tax increases. I think it would sort of be fair play to do, but whatever you give us will be a substantial help going forward. And that is one of the very best things in the Contract. It is excellent.

Second, in the Take Back the Streets Act, I am a believer in prevention, but I don't think there is enough prevention money in the act to make a difference and I am not disinclined to go along with the Take Back the Streets Act in moving the prevention money around, but rather than to give $2.5 billion to prison construction, and the crime bill already has plenty of money for prison construction, 4,500 new cells in Pennsylvania. Rather than give it to us for prison construction, give it to us for police.

Because under the Take Back the Streets Act formula, Philadelphia can get 367 police fully funded and that is great as opposed to the 1,000 police under the crime bill where we have to share a part of the burden, where we have to come up with a local match but we need more than the 367 police. Police on the streets are going to be more valuable to us than more prisons in addition to the prisons already created. So I think that is a change that I would like to recommend to you very seriously.

On the AFDC question, I share with my fellow Democrats some trepidation about what the Contract would do to AFDC. I have to be honest with you, and the reason I share the trepidation is I am not sure that work programs are available. My State in June of last year cut off welfare for single males and females from the ages of 45 to 65. Produce some job training money and said no problem, we will all get jobs.

In my city alone, there were 5,500 people in that group that were impacted. So far in a half year, the State has managed to produce 361 jobs for the entire State, not just for Philadelphia, and to say that there will be public service jobs as I heard Governor Weld say in some discourse with some of the members of the committee, I don't think that—number one, public service jobs cost a lot of money. There is not going to be a public service job for less than $9,000 or $10,000 and that is probably more than we give to most AFDC families right now, substantially more. And second, as I read the Contract, within 5 years, you can no longer have subsidized work programs for those families.

I just don't believe from the type of people who are on AFDC and their level of training and skills that there are jobs available. And what will happen is what some of the Congressmen have alluded to: The problems will be passed down to us. So I think that is an important thing to look at.

I share my fellow mayor's belief that one of the things you can do for us, and the Contract does it in part, is use tax policy to help investment to build jobs. I am a Democrat. I am for capital gains reduction and in fact I am for exemptions in certain circumstances but not for everyone. Not for people who want to take capital gains for buying art. Not for people who want to take capital gains for Krugerrands, for buying Krugerrands.

Aim for capital gains reductions for those things that will produce jobs. And if you target it, as Mayor Goldsmith said, to low-income areas, let's have the enterprise zones and the empowerment zones together, let's have capital gains exemptions for investment in those zones that produce jobs.

So there are wonderful things for us in the Contract With America. We hope as you draw the line, you draw it appropriately.

And on the balanced budget amendment, I am willing to give this Congress the benefit of the doubt, but before we sign on as mayors, I think it is important that we see where the cuts come from. And I am willing to wait to see what happens because we have to gauge the effect of those cuts on our cities and our residents. So I think the Contract With America has a lot of good in it.

I would love to see a tax policy that Mayor Goldsmith and I have outlined. Congressman Coyne has put in a bill which is so vitally important to cities, the restoration of the historic rehabilitation tax credit. I know that was in the last Congress. I don't know if he has reintroduced it. That is a bill that would cost the Federal Treasury hardly anything when you balance the setoffs and we need it now.

In less than a decade, it produced 27,000 jobs in Philadelphia and put 35 major buildings that were moribund back on the tax rolls. So there is a lot that this Congress can do. We ought to work together as Republicans and Democrats, fashion the things we believe in in a way we can agree and let's get this country moving again.

[The submission is being held in the committee files.]

Mr. CRANE. Thank you very much.

And first to question the witnesses, Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman.

I thank both of you gentlemen for joining us today and sharing with us your ideas of how we can help the city.

And, Mayor Rendell, thank you for your comments on the Contract With America. All input is appreciated, even if it is contrary to what we want to have in the Contract. As the Speaker has said, and I reiterate, the Contract is not written in stone. So we do truly appreciate all input that we are receiving, and we are getting a lot of it.

I was particularly impressed with both of your comments on the Tax Code and how we can use the Tax Code to stimulate growth, economic growth, in our urban areas. And you mentioned a couple of things, targeting capital gains, either exemptions or reductions to urban areas, perhaps even income tax. I heard Mayor Goldsmith say giving more favorable income tax rates to people to live in urban areas. I wonder if you might flesh out that list for us while you are here with any other Tax Code changes that you think would improve the prospects for rebuilding cities.

Mr. GOLDSMITH. Yes, sir. Actually, there are a range of them, and let me just quickly reiterate the principle. I think we all are interested in wealth increasing rather than wealth redistribution. And I represent both a suburban and urban area, and in my area if we can keep those rings of poverty from growing—

But the problem—and I spend half of my time on economic development, is businesses because the Federal Government has written off a lot of my lands as environmentally unacceptable, because crime rate is high, schools are bad. It is difficult. So I am trying to equalize the marketplace and then get out of the welfare grant system.

You could do something really dramatic which is take back all the money and all your welfare programs and give me *x* percent less flat tax rate.

Or you could say we will take the most impoverished areas of the core cities and cut their capital gains by half as much again as you do in the suburbs.

Or you could say, all right, you can use Tax Code policy more targeted. We can have a tax credit—you would do a lot better to get away with your job training money and give more ambitious tax credits and let me hire somebody who is on unemployment. Or a historical tax credit to take an old building and put it back on the marketplace.

You passed in the last Congress—reauthorized the LIFT program for low-income housing tax credits. I think there is a range of areas where reasonable people can agree or disagree.

But the point is if we can equalize the market it does—just in conclusion—it has a couple of other effects. It wipes out all the bureaucracy. Because it is a tax credit, we don't need people passing the dollars through. It makes the dollars used more widely because someone still has to invest private capital, which is a sanity check on the program itself, and it uses wealth creation strategy.

I appreciate the question. I would just say take away all the grants and eliminate all of them and make our flat tax flatter than the others. Or, in the alternative, if we are not prepared to do that, let's target some tax credit strategies around buildings and low-income jobs.

Mr. RENDELL. And I don't think the Congress is probably prepared to do the first part of Mayor Goldsmith's suggestion, but I do think that targeting and incentivizing aid to cities works. And the impact on it doesn't have to be enormous, Congressman, in terms the Federal Treasury.

Take the historic rehabilitation tax credit. I know that the CBO estimated that it would cost about $4 billion over a 5-year period if we restored that in income that would be sheltered from taxation that IRS is getting now.

That is correct, but the CBO never gives you the upside. It is so frustrating to us. The upside is for every $1 million invested in the historic rehabilitation tax credit, $217,000 gets sheltered that the IRS doesn't get. But it produces $787,000 of income on wages that is spent on wages out of every $1 million. Taxed at the lower rate, it produces $280,000 of Federal income tax, not counting the State real estate tax, the State income tax, the city wage tax that we would get from that. So it is a revenue-neutral or maybe slightly positive idea for you, and it is wonderful for us.

You have got all sorts of restrictions on tax-exempt financing, arbitrage rules, State volume caps. Get rid of those. Bring back the IDBs and, most of all, capital gains. I was the great supporter of Secretary Kemp's enterprise bill because it had capital gains incentives in it.

I thought the President's bill was terrific. The empowerment zone concept was great, and we won one of the zones. Everything was great about it, except it didn't have capital gains reductions or exemptions.

Those are the types of things that fit your philosophy and help cities just as well. It is good philosophy because we want to put people back to work. Do you want to sit there and give someone capital gains reductions for buying and selling art? I don't think so.

Mr. McCRERY. Thank you for your testimony, Mayor Rendell. I may have heard you wrong. You did say that you are a Democrat.

Mr. RENDELL. I am a good Democrat, but I think we should take the best ideas of both parties—and we have got a terrific opportunity to do that now—the best ideas of both parties and merge them together. Capital gains relief is a Republican principle, a supply sider principle. Target it to investment and help poor rural and urban areas. It is a dynamite idea. It is a home run when you take the best of both of our philosophies.

And on some things we are going to disagree. And I probably disagree with you. Until I see the list I disagree with you on the balanced budget. I disagree with you on AFDC for the reasons that I expressed. But for some things this is music to our ears in cities.

Mr. McCRERY. Thank you for your comments on dynamic scoring. We have been talking about that on this side of the aisle for a long time. I appreciate your comments.

Mr. CRANE. Mr. Ford.

Mr. FORD. Thank you, Mr. Chairman.

Let me welcome the two mayors to the committee.

You know, the Contract With America changes tax laws and Federal regulations with the notion that cutting taxes on investments and eliminating costly Federal regulations will pump enough money into the economy to create those new jobs. Mayor Goldsmith, I think you talked about those regulatory changes and all of the tax cuts that will pump it up. But didn't we hear this in the eighties with the Reaganomics? Didn't we have similar tax cuts and changes in Federal regulations in the early eighties under the Reagan administration? I know you were not yet mayor of your city at that time, but did all of these problems go away in your area during the eighties?

Mr. GOLDSMITH. I think the proposition for which I stand, Congressman, is that you, the Congress, imposes on urban cities, and particularly on its poor, more costs through mandates than the benefits of the grants. And every one of these mandates has a cost.

For example, the environmental mandates make sure that we have quarantined urban land near the poorest areas and we can't invest or build or loan or develop. And Ed has his own examples. So a more rational cost benefit approach to those mandates would essentially cause investment to flow and jobs to be contributed.

Mr. RENDELL. And on the question of taxes, I agree with you that just generally believing that by giving tax incentives things are going to happen. That that may or may not work. I don't think there is any conclusive evidence. But if you target it to specific investment programs that are job creating, that is different.

Again, I don't want to see some rich guy invest in Krugerrands and then sell Krugerrands and get a capital gains reduction. I don't want to see that, and I don't think you do either, Congressman.

But I do want to see that same rich guy shelter some income by investing in a moribund historic building in the city of Philadelphia or Indianapolis or Chicago or St. Louis and—because by sheltering that investment someone can raise enough money to rehabilitate that building and put people to work constructing it and put people to work working in it once it is finished and put it back on the tax rolls, yes, that does work.

The historic rehabilitation tax credit was a smash success for cities in the eighties. And, in our own experience, we put in a real estate tax abatement for 3 years for new construction over for rehabilitation, the city of Philadelphia did, and our new construction on rehabs went through the roof, absolutely went through the roof.

So, yes, I believe properly targeted tax incentives, using whether it is our code in Philadelphia or your code in the Federal Government, do produce jobs. There is no question about it. Do create investment.

Right now, the biggest problem in Philadelphia—it may not be in Indianapolis, but it is in Detroit and Cleveland and Newark and L.A.——

Mr. FORD. Would it be a part of the Tax Code they are using in suburban areas or my area and your area?

Mr. RENDELL. They don't need it. We do. Remember what Mayor Goldsmith said. We need you to level the playingfield. We are losing everybody to the suburbs.

Mr. FORD. What section of the Tax Code are these businesses?

Mr. RENDELL. They don't need it because their local taxes are nil compared to ours. And the reason our taxes are so high is because we have in our metropolitan areas 80 percent of the poor people who need services. And we should give them services. But we pay for the services that they don't have to pay for. And, as a result, our taxes are high. Their taxes are low. Everybody is forced to cross the border leaving us with less revenue to deal with the people who need services. It is a vicious circle.

Mr. FORD. One final question to Mayor Goldsmith.

You were talking I guess about the public assistance programs earlier when you talked about welfare recipients receiving welfare wages. The benefits are higher than what the wages would be on many minimum wage jobs. And, you indicated that it is so attractive that people do not want to seek employment in the private sector, but would prefer staying on the public assistance rolls.

Evidence shows that about 70 percent of all AFDC recipients come off of AFDC within the first 15 months and signals that people don't want to be on the assistance rolls and want to be self-sufficient of the government itself.

Mr. GOLDSMITH. Congressman, that is absolutely true. There are some people——

Mr. FORD. Seventy percent.

Mr. GOLDSMITH [continuing]. Who find their way to the workplace despite all the obstacles of the welfare system. We are succeeding despite all the rules of the game.

And just to add that question and the last to Mayor Rendell's, in the old pre-Ed Rendell days in other big cities we taxed our people who had money in order to redistribute it to people who were poor, and suddenly people who had money said I am going to move. And as they moved we kept taxing the smaller and smaller base. And we see now that won't work.

We are saying—if the numerator is poverty and the denominator is wealth, poverty is growing faster than wealth. And we want wealth to grow faster than poverty. And I am suggesting that the welfare system needs to be restructured to provide more encouragement for people to find jobs.

Mr. CRANE. Next is Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. And thank you, mayors.

And, Mr. Rendell, I appreciate the fact that you identified yourself as a Democrat. I couldn't look at either one of you and tell. Neither one of you wear uniforms, but I do like your comments, especially in the area of capital gains.

I believe the capital gains tax reduction will create jobs. I would like to see us, in some way, target inner cities, enterprise zones or empowerment zones in other ways in the Tax Codes because I look at capital gains as a tool for new investment.

And I can respect the fact that the historical projects that you would like to work, but I see those as limited times for maybe 1- or 2-year jobs. I would rather see us concentrate on manufacturing jobs in some of those inner-city areas, and I would like to see us concentrate on the area of industry that we may be losing offshore today because of low wages in other countries.

But I don't think low wages in other countries is the only thing that is drawing our business and industry to those countries. I think a lot of it has to do with the burden that the Federal Government places on businesses through regulation and taxation.

What would you think about some other type of tax incentives that we could offer for industry that we are losing today? Because if we offer tax breaks to industry that we are losing, we haven't lost anything because we have already lost the industry. It would lure them to the inner cities.

Mr. RENDELL. That is really a terrifically complex question. In the general sense, you know, I believe—and you know in the GATT agreement we have eliminated subsidies prospectively in that agreement. And foreign countries are going to have to live with that agreement as well. So there won't be any more subsidized shipbuilding if they live up to that agreement in other countries so we can compete here.

And, by the way, just what Congress did in GATT by eliminating those subsidies, we now have at the Philadelphia Naval Shipyard, which is one of the shipyards that is being closed, we have interest by Danish and German shipbuilders, some of the best in the world, in coming to the Philadelphia Naval Shipyard to set up because they know that there aren't going to be subsidies anymore so America has now got a better level playingfield. I think anything where we can use our influence to either eliminate subsidies worldwide or fight back I would be in favor of.

For cities particularly, though, for cities particularly, I have an idea that I think would help the country and help cities. You know, in foreign aid—and we give out significant foreign aid, not as much as we used to but significant foreign aid.

You know, of course, Congressman, that the Japanese when they give foreign aid they tell the country, fine, you tell us what you need, and you have got a credit. You come and buy it from a Japanese company. You don't get Japanese yen to spend in Africa, if you are an African country, or in Asia, if you are an Asian country, you get a credit.

France is now doing it. I think Italy is considering it. I believe we ought to do it and take a portion of that productivity and mandate that it comes or direct that it comes from urban areas. Ten percent, 15 percent must only come from companies located within distressed urban or rural areas, distressed areas—there are 101 enterprise zones now, some rural and some urban. Those would be the target for that.

We have got to fight back. That would keep our foreign aid helping Americans as well as those foreign companies.

Mr. GOLDSMITH. One brief comment. Congressman, your question is helpful because it raises two issues: One is the reuse of urban land through capital investment which is one issue. The second is how to keep people and their dollar bills from moving—that is part of the first. The second is how to create jobs for people who don't have jobs.

If you would focus on the second, which I think is the thrust of your question, a payroll reduction—a payroll tax reduction for a person who creates a job where they are employing somebody who was on welfare is more powerful than a job training dollar we pass through the system.

We know the job training dollars are relatively ineffective. So you could target tax credits for unemployed—for people who have been taken off of unemployment and put into the regular work force.

So we could either target capital investment, which has dollars move to our city cores, or target credits for people—for companies who employ people who are unemployed. And I think the latter would be a very effective incentive.

Mr. COLLINS. Thank you. Thank you, Mr. Chairman.

Mr. CRANE. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman.

It is an honor to have Mayor Rendell here, not merely as the chief executive of the largest city in my State but also as an executive who inherited a city in deep financial crisis and who developed an innovative financial approach to bringing the city back, reassuring bond markets, downsizing city government in a very dramatic way, and also, in my view, restoring a real sense of community in Philadelphia. And I would like to congratulate you for that and thank you for bringing your expertise to this panel.

For both mayors, I wanted to thank you not only for your testimony but also with regard to Federal mandates. Both of you specifically have, in a big way, reorganized your forms of service delivery locally. Can you outline for us some examples of how Federal mandates have gotten away—in the way of your process of reinventing local government?

Mr. RENDELL. Well, the worst thing about—and, Congressman, thank you very, very much for your kind remarks. And I know you are filling big shoes in our new Governor's congressional seat, but I know you will do very, very well, and good luck to you as well.

In the very realest sense what mandates do is rob us of our ability to prioritize our dollars to the needs of our constituents. And we know better, obviously, what the needs of our constituents are than a Congressman from California. Obviously, we do—or a Senator from California—because we hear about it every day.

There is one thing about being mayor. You hear from the public. They are outside my office every day. In fact, a friend of mine from a community group said if you don't do this, Mayor, we are going to come down and picket outside your office. And I said, Fred, do me a favor. You are a friend of mine. Call me before you come so I can make sure you can get space out there so there aren't other groups picketing in front of you.

So we hear from our public, very much so. And what mandates do is rob us of the ability to make our own decisions.

For example, the Americans With Disabilities Act, which I know is exempted from S. 1 and may be exempted from whatever the final bill will be—but under the Americans With Disabilities Act a Federal court determined that any time we did street repaving that that triggered the part of the ADA that said that whenever there was major street reconstruction we had to put in curb cuts.

So every time—we have a $15 million capital budget for street resurfacing in the city of Philadelphia. Now every time we have to resurface a street we have to put in a curb cut. It costs us about $3.5 million to put in those curb cuts so it has reduced our resurfacing budget by over 22 percent, and with that $15 million we are not coming close to the streets that ought to be surfaced. And, worse, sometimes we are putting in curb cuts on streets that have no sidewalks because they are in wooded areas of the city, but we have to put in curb cuts. It makes no sense, and it robs us of our ability to make the decisions of what is more important for our taxpayer as we do in everything else.

Mr. GOLDSMITH. I agree—I will give you two examples on the other half of your question.

Mass transit around this country doesn't work very well. The Congress of the United States has told me, as a mayor, that despite the fact that I have competed and privatized a whole series of city services and every time I have done that I have saved money and enhanced the delivery service, you have told me that I cannot effectively compete mass transit. It is a congressionally guaranteed monopoly.

If I compete it out, you require me to give every existing employee and driver 6 years of full benefits—6 years, even if I compete it out. Poor people in my community have worse service. Minority businessmen and women cannot bid on their own service. Poor folks can't get to their jobs. But the Congress prevents me from breaking up that monopoly.

There are—the Tax Reform Act says that—the Congress of the United States and the Tax Reform Act has said we prefer socialism to capitalism. I cannot sell my wastewater treatment plant because of the Tax Code of the United States.

So the Tax Code itself, in various little mandate provisions, creates monopolies which cause inefficiency. Then you give us more grant money to be more inefficient. We would be delighted to respond with a long list of ways that you have inhibited the privatization process.

Mr. ENGLISH. Thank you, Mr. Chairman. And thank you, Mr. Chairman.

Mr. CRANE. Dr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

If each of you would tell me how much you get in community development block grants.

Mayor Rendell.

Mr. RENDELL. CDBG, $62 million.

Mr. MCDERMOTT. $62 million.

Mayor Goldsmith.

Mr. GOLDSMITH. $12.

Mr. MCDERMOTT. $12.

What is the difference in your two cities? Are they a lot bigger than you?

Mr. GOLDSMITH. He was a more effective lobbyer.

Mr. RENDELL. It is a formula. We are 1.6 million and, unfortunately, have a 25-percent poverty level.

Mr. MCDERMOTT. So you are building your fiscal year 1996 budget. What have you put in your budget for Federal grants? Have you put in the money you have had this year and run it forward with inflation or reduced it by 10 or 20 or 30 percent? What have you done?

Mr. RENDELL. CDBG funds don't go into our operating budget. The beauty of CDBG funds is that they are probably the most unrestricted Federal funds that we get. It was a program that was started by President Nixon. I think it is the best program because it has the least strings.

What we do with CDBG funds is basically pass them through to either community development corporations, private developers, people who are building subsidized housing for low—middle- and low-income people.

Mr. MCDERMOTT. Are you using them for the police force or the fire department?

Mr. RENDELL. No.

Mr. MCDERMOTT. No money is going in in any way?

Mr. RENDELL. It is about 85 percent housing and 15 percent commercial economic development. But that has to be in CDBG-eligible areas. So that doesn't come into our general fund.

You are thinking of the old revenue sharing days, and none of us want to go back to those days, where we could use the money for anything we want.

Mr. MCDERMOTT. How about in Indianapolis?

Mr. GOLDSMITH. Our cities are very similar in that regard. We keep none of the CDBG. We pass it all through to community groups on the condition that they leverage it against private dollars for basically low-income housing.

Mr. MCDERMOTT. And you are not expecting any loss in that money? You don't budget it, but you—there will be no impact if this Congress cuts that money?

Mr. RENDELL. We do expect a little bit of a loss, regardless of what the Congress will do. But what the President and Secretary Cisneros has said is that they are taking $700 million out of the program. And that $700 million is not a great deal extrapolated out over the cities.

But let's assume our allotment fell to $59 million next year. We would just approve less projects by CDCs or——

Mr. MCDERMOTT. What money do you get directly from the Federal Government that goes into your budget?

Mr. RENDELL. That goes into directly? Well, for example, the crime bill money will now go directly into the police department budget.

Mr. MCDERMOTT. Anything else?

Mr. RENDELL. I guess there are a number. Transportation money goes into our—we get capital money for transportation from the Federal Government. We get very little operating money directly from the Federal Government. We do get money for children and youth, foster care, for abused children. That comes from the State, but it is essentially Federal money that is passed through from the State.

And if we—if that was reduced by 10 percent, for example, on our children and youth budget, that would have a dramatic effect.

Mr. MCDERMOTT. And have you built in the amount this year for next year or are you expecting a cut there?

Mr. RENDELL. In our budget for next year we have built in no increase but no decrease.

Mr. MCDERMOTT. You think they are going to leave you alone? They are going to leave you whole in the appropriations process here in the Congress?

Mr. RENDELL. I think because of the different fiscal years that the State and the Federal Government go under, I think we are probably OK for this year.

Mr. MCDERMOTT. For 1 year. But you will be in big trouble the second year.

Mayor Goldsmith, you are shaking your head.

Mr. GOLDSMITH. The question is a legitimate question, Congressman. I am only shaking my head because I don't want to be Pollyannaish about this. Federal policy has, in part, destroyed cities, and now you can't just dial back 30 years and instantly recreate the market.

So if on one hand you take out all the grant money and don't readjust tax policy or anything else it will be very difficult for us to succeed. If you add the other half of the Contract With America, which is you want to balance the budget and take our grant money but you are willing to think of new, flexible ways for cities to create wealth, then we can do it.

But we can't be left in this funny situation where you spend a lot of money on welfare subverting the marketplace and at the same time take away the grant money. If we radically changed our relationship——

Mr. McDERMOTT. Could I ask you one question? My time is about up.

Mayor Rendell, you said you support the 60 percent. Do you have a 60-percent requirement on your municipal bonds?

Mr. RENDELL. No, nobody asked me about the 60 percent for taxes. What I said is, since the House has passed the 60 percent for taxes, I would like to see the same 60 percent for passing an unfunded mandate which in the bill is now 50 percent. I think—I am a lawyer, and I am not even sure that the 60 percent is constitutional.

Mr. McDERMOTT. That is good I clarified this. You are not advocating as mayor that it require 60 percent to pass a municipal bond issue?

Mr. RENDELL. No, I think 50 percent is sufficient. I don't think we should create artificial structures to force us—what we ought to have the guts to do if we have the political will to do it.

Mr. McDERMOTT. Where are you on that, Mayor Goldsmith? Do you think it should require more than a supermajority to pass an issue here?

Mr. GOLDSMITH. That is not my issue, Congressman. I just want to be liberated at the local level, and however you do that is fine with me.

Mr. McDERMOTT. You mean you would like to stay out of the fight. And you certainly wouldn't want to be limited by that kind of thing in raising your taxes in Indianapolis, would you?

Mr. GOLDSMITH. I can't afford to raise my taxes because it destroys wealth generation.

Mr. McDERMOTT. I understand. You are never going to do it, of course.

Mr. GOLDSMITH. I think a plebiscite of the people or a supermajority of my local legislature would be appropriate to restrict me from raising taxes.

Mr. CRANE. The time of the gentleman has expired.

Mr. Hancock.

Mr. HANCOCK. Thank you, Mr. Chairman.

I would like to go on record real quick that I am very much in favor of a supermajority for raising anybody's taxes.

I have a quick question, and I think probably I would really need ask, if you can, to submit this—the answer, later.

Currently, Congress is considering legislation to find ways to relieve State and local governments of the cost of Federal laws and programs. Do you agree or disagree that tax-exempt financing is a useful tool in leveraging your resources in order to finance not only

Federal mandated infrastructure but other needs as well? Is it a useful tool?

Mr. RENDELL. Absolutely. And, as I said in my answer to I forgot whose question, I think it was Congressman Collins, that is an area where we would like to see a lot of restrictions lifted dramatically—the State volume cap, the arbitrage limitation, things like those. So, yes, we think it is a very valuable tool.

Mr. HANCOCK. The next one, as part of this, you do have suggestions for the committee, and I have not had a chance to read your testimony. But, if you would, we would appreciate any detailed suggestions that you might have that you can submit to the committee which could be made a part of this hearing at a later date.

Mr. RENDELL. I will.

Mr. HANCOCK. And we will appreciate any information you might have.

[The following was subsequently received:]

Issue #1

Description of Issue--**Municipalities which undertake purely governmental projects should not be required to rebate to the federal government earnings made on the investment of bond proceeds that have been borrowed to undertake such projects.** The governmental projects referred to in the preceding sentence are intended to include, but are not limited to, projects such as road construction, sewer and water main construction, and municipal building construction projects; and do not include projects, the principal beneficiaries of which are non-governmental entities, such as corporations or private business partnerships.

Since the effective date of the 1986 Tax Act, local governments have been required to rebate to the federal government certain investment earnings on borrowed moneys. Prior to the adoption of the 1986 Act, this requirement had been applicable only to bond proceeds which were borrowed for the benefit of private (i.e., non-governmental) parties, such as developers, and had not been applicable to local governments borrowing money to undertake purely public projects.

The federal government requires that any investment earnings which are in excess of the interest paid on the bonds must be rebated to the federal government. By requiring the rebate of these amounts, the federal government has effectively increased the borrowing costs of the municipality for its capital projects. The municipality is prevented from "re-investing" the rebated earnings in the public projects, thereby increasing, incrementally, the amount which must be borrowed for the projects, as well as the amount which the municipality must budget for debt service to repay the increased borrowing.

Rationale for Issue--A significant factor in the amount of any investment is the cost of capital. The ability of governmental entities, including municipalities like Philadelphia, to invest in infrastructure projects is directly related to the amount and cost of the capital needed to finance the particular projects. Traditionally, municipalities had been able to minimize their capital costs by borrowing money at tax-exempt rates and re-investing all earnings in the projects for which the money had been borrowed. This permitted the municipalities to "net fund" these projects, i.e., take into account all investment earnings and apply them to the costs of the projects, thereby borrowing less money to finance the construction of the projects. Obviously, amounts required to be rebated to the federal government are unavailable for investment and the real costs to the municipalities of completing their projects are increased.

Impact on Philadelphia and other Cities--Since the imposition by the 1986 Tax Act of the rebate requirement with respect to proceeds used to construct purely governmental projects, municipalities like Philadelphia, have paid the price of rebate in two respects: (1) the amounts which have been transferred to the federal government to make rebate payments; and (2) the commitment of the scarce resources of the municipalities (i.e., time, personnel, contracting with outside firms to calculate and advise with respect to the rebate requirement) to ensure compliance with the requirement

Generally, municipalities are required to rebate excess earnings to the federal government every five years. The effective date of the rebate requirement as applied to bonds issued by governmental entities undertaking purely public projects was generally August 19, 1986. Therefore, 1992 was the first full year in which significant revenues were transferred to the federal government in order to comply with the rebate requirement.

As of the date hereof, the City has rebated $2,442,400 to the federal government in order to comply with the rebate requirement and the City expects to rebate an additional $2,027,000 before the end of this calendar year.

In 1993, ***The Bond Buyer*** (November 18) reported that state and local tax-exempt bond issuers "are expected to rebate $305 million in arbitrage profits to the federal government [in 1993]- about 5% more than [1992]". ***The Bond Buyer*** went on to report that

> [b]efore 1992, issuers' arbitrage payments to the IRS had risen steadily each year, but still remained below $100 million. The IRS collected $72 million in 1990, $22 million in 1989, $16 million in 1988, and $17 million in 1987.

The significant increases in 1992 and 1993 over prior years in amounts rebated to the federal government are attributable primarily to the expansion of the rebate requirement by the 1986 Tax Act to the proceeds of bonds issued for purely public projects.

Related Existing and/or Potential Federal Legislative Vehicles--The only current legislative vehicle, to my knowledge, which attempts to address the problem of rebate is the Public Finance and Infrastructure Investment Act of 1993 introduced by Representative William J. Coyne. Unfortunately, for Philadelphia and other large urban municipalities like it, this Bill does not go nearly far enough. The Bill contains two provisions which are intended to ameliorate to some extent the negative effects of the rebate requirement: (1) one provision would expand the universe of issuers not required to rebate to the federal government by merely increasing from $5 million to $10 million the limit on the amount of bonds which such an issuer may issue in a calendar and continue to qualify for the "small issuer rebate exception"; and (2) the other provision would increase another "small issuer exception", this one is referred to as the "bank qualified exception" and would redefine a small issuer for these purposes as an issuer of $25 million (increased from $10 million) or less of tax-exempt bonds in a calendar year.

Before the 1986 Tax Act commercial banks were significant investors in tax-exempt municipal bonds (holdings at of the end of 1985 were $231 billion of all bonds outstanding or 35%) because they were allowed to deduct 80% of their interests costs associated with holding tax-exempt bonds. This deduction has been limited in its application since the adoption of the 1986 Tax Act generally to banks which purchase the bonds of issuers which issue no more than $10 million of tax-exempt bonds in a calendar year (holdings as of the 2nd quarter of 1993 were $97 billion). By reducing the universe of investors, this imposes an additional cost on issuers by increasing the yields which must be offered to their remaining investor pool.

Large cities, such as Philadelphia would not directly benefit from either of the aforementioned provisions in the Coyne Bill because they will never be defined as "small issuers". A more plausible approach for such cities might be an exception to the rebate requirement should the issuer spend at least 85% of the proceeds of the bond issue within a three year period (often referred to as the "temporary period" in bond parlance). This is a certification which nearly every issuer makes today in order to ensure the tax-exempt treatment of its bonds, therefore it should not impose additional burdens on issuers.

Revenue Impact on Federal and Local-Level--The federal government has collected more than $611 million in rebate payments over the last six years, however that may not represent all of the costs. In a June 4, 1993 article in ***The Bond Buyer*** it was reported that

> State and local officials were not happy about the millions of arbitrage dollars going into federal coffers
>
> "We could build a lot of infrastructure with that money," said Catherine Spain, director of the Government Finance Officers Association's federal liaison center.
>
> Spain said the arbitrage rebate payments "are only a fraction of the costs" of the tax laws rebate requirements. State and local issuers must also spend millions of dollars tracking expenditures and investments of bond proceeds, doing rebate calculations, and taking other steps to comply with the requirements, she said.
>
> "It's a high price to pay at the state and local level and it's probably not significant at the federal level," Cross said. "At this difficult time of balancing budgets, there's not a state or

local government that couldn't put these funds to better use."

Amy Dunbar, Director of governmental affairs for the National Association of Bond Lawyers, said arbitrage rebate "is a revenue-sharing program for the federal government, paid for by state and local governments."

When issuers rebate arbitrage on bonds used to finance infrastructure, Dunbar said, "some of the benefits of infrastructure investments are not staying at the local level" because the federal government uses the rebated money for other purposes.

Issue #2

Description of Issue--**The federal government should assist the economic development efforts of urban cities by reauthorizing the issuance of tax-exempt private activity bonds for commercial purposes.** The 1986 Act contained a number of provisions which, from the perspective of the federal government, properly withdrew the federal government's subsidy of "private activities". These provisions include the sunset of the provisions which authorized the issuance of tax-exempt private activity bonds for (i) commercial enterprises (to be distinguished from manufacturing facilities which may continue to be financed on a tax-exempt basis); (ii) sports facilities (if this provision had not expired the financing of Spectrum II would have been permitted); (iii) convention and trade show facilities; (iv) industrial parks; (v) air/water pollution facilities owned or operated by the private sector; and (vi) free standing parking facilities owned and operated by the private sector. In addition to expanding the types of private activity bonds which may be issued, the small issue exemption which is currently at $10 million should be increased significantly (possibly up to $50 million) to reflect the significant level of economic activity which is needed in today's urban centers.

Rationale for Issue--Philadelphia's economy, like the economies of many other northern industrial centers, has changed from a primarily manufacturing based economy to a more service based economy. The changes in the 1986 Tax Act, which allowed the authorization of manufacturing industrial development bonds to continue while permitting the authorization for commercial industrial development bonds to expire, has had a significant adverse effect on the investment in businesses and jobs in Philadelphia. Cities such as Philadelphia which are being transformed from manufacturing based economies to service based economies should be permitted to give incentives to those businesses and commercial enterprises which make up the fastest growing component of their economies by issuing tax-exempt bonds on their behalf.

Impact on Philadelphia--Attached hereto as Appendix I is a chart prepared by PIDC which tends to reflect the dramatic adverse impact of the 1986 Tax Reform Act on the investment by businesses in Philadelphia. In one year from 1986 (the last year tax-exempt commercial industrial development bonds were permitted) to 1987 the total number of projects were reduced by more than half. It would appear from the Appendix I that the number of projects being financed by PIDC/PAID is approximately 25% of the normal pre-1986 volume. Similar trends are evident with respect to the employment statistics as well, and although one should heed the cautionary note contained in the Appendix regarding their worth, I am not sure I would conclude that these numbers are worthless. The "total project cost" is not intended to reflect how much is financed by tax-exempt bonds, but is intended to indicate the total costs of all projects for which PIDC received applications during the relevant year (there are probably included in these figures taxable financings as well). Also, the "new" employment statistics contained in the Appendix reflect the estimates made by applicants to PIDC for assistance. Nonetheless, the significance of the 1986 Tax Act is not lost upon examining Appendix I. Web Christman of PIDC provided me with the table included in Appendix I and may be called upon to give additional interpretations regarding the data included therein.

Related Existing and/or Potential Federal Legislative Vehicles--The Coyne Bill referred to above includes provisions which permit the issuance of manufacturing and commercial industrial development bonds, provided the proceeds of such bonds are used in an area designated as a "distressed community" within the meaning of the Bill. Philadelphia would probably qualify as a distressed community under the Bill because one of the determinants of a municipality's status is whether "there has been a military base closing within its boundaries within the last 2 years which has resulted, or will result, in the loss of not less than 500 jobs".

Revenue Impact on Federal and Local Level--I have not been able to obtain any statistics which indicate the impact of revenues at the federal and local level. However, the magnitude of the problem is reflected somewhat in the figures set forth in Appendix I showing the sharp reduction in projects completed by PIDC/PAID after the effective date of the 1986 Tax Act.

I hope the foregoing is satisfactory for your purposes. If you should need additional information, please do not hesitate to contact me.

C.D.A.

cc: Ben Hayllar
Thomas Queenan

Mr. HANCOCK. We know what has happened in Michigan and some other States. The question that Mr. Christensen asked, how we get away more and more from the property tax? In other words, trying to come up with either a sales tax or some other choice.

I understand that a few years ago the city of Philadelphia started experimenting with what is called land value taxation, am I correct in that?

Mr. RENDELL. The city of Pittsburgh. The city of Pittsburgh experimented with land value taxation where there is a higher tax rate for unused land than there is for land that is used as a way of taking people—in those days—it was the eighties. It was the eighties when people had money to burn, and everybody was investing money. And a lot of people would just buy up land and sit on it for the right investment opportunity, and that was causing a lot of the land in Pittsburgh to go undeveloped.

So they wanted to prod development and sort of penalize you for buying land and land-banking it as sometimes the government does, so they instrumented with a land value tax.

In some areas I think it can be successful. In our area it wouldn't be successful.

Our problem is not in people buying land, sitting on it for investment opportunities. Our problem, Congressman, is what Mayor Goldsmith alluded to. A lot of our land has been rendered valueless, some of it by Superfund and environment legislation which says if it is former industrial land, which says, hey, if you don't clean this up 100 percent and assume liability for anything we find later on then you can't, you know, take over the land. So, as a result, we can't get anybody to come in and look at that land.

So our problem is the other end of that spectrum in Philadelphia. We have land because of legal limitations and because of crime and things like that that nobody wants to invest. Nobody is buying to land-bank on it anyway.

Mr. HANCOCK. I am assuming the same situation in your area in Indianapolis.

Mr. GOLDSMITH. Yes, sir.

Mr. HANCOCK. You mentioned the problems with the Americans with Disabilities Act. You mentioned the problems that when you pave the street that just because you are repaving that you have got to put these curb cuts in. Is that the only problem you have had as the mayor of a city with the Americans with Disabilities Act?

Mr. RENDELL. Oh, no, no, no. Our biggest problem is that unless we are successful in getting a waiver from the Justice Department, who seems as confused over some of the provisions of ADA as we are, we are going to be required by the end of 1995 to put curb cuts on every one of our streets, which would cost us $150 million, and our total capital budget for any year is $120 million. I can't figure out how we are going to do that.

Mr. HANCOCK. Curb cuts is just part of the problem.

Mr. RENDELL. Yes. And there are access ramps. There are a whole lot of things. I hate to speak about that because somebody says you are against access for the disabled. Absolutely not. We are not. We want it done in a reasonable way.

Mr. HANCOCK. Have you had anybody sue you yet because they slipped and fell on a curb cut?

Mr. RENDELL. No, but it is interesting because the visually impaired disabled do not like curb cuts and tried to stop them. The blind do not like curb cuts and tried to stop them.

Mr. HANCOCK. I wonder if there has been a case where a city has been sued because of somebody slipping and falling on a curb cut. The reason I was asking is because my wife seriously injured herself with a curb cut not too long ago.

Mr. RENDELL. Not yet.

Mr. HANCOCK. Well, it is coming. Thank you.

Mr. CRANE. Mr. Camp.

Mr. CAMP. No questions.

Mr. CRANE. Mr. Kleczka.

Mr. KLECZKA. Based on the question from Mr. Hancock the further question is, is your wife suing?

Mr. HANCOCK. Not yet.

Mr. KLECZKA. Let me take Dr. McDermott's point one step further since he did steal one of the things I wanted to discuss. Let's say in 2 years the community development block grants are totally eliminated. And let's also say that low-income energy assistance is totally eliminated. Will that provide a hardship to your cities?

Mr. RENDELL. A tremendous hardship. And that is why I don't even want to be asked to sign on to a balanced budget amendment until I see what is going to be cut.

If you cut LIHEAP, unless somebody steps forward, and the State of Pennsylvania doesn't have enough money—and, Lord knows, we don't—you are going to have people who are looking for work, can't find work and have kids, and those people are going to run the risk of freezing to death or they are going to turn on their stoves and run the risk of those apartments going up in flames.

Mr. GOLDSMITH. Well, I am tempted to agree with that on most subjects. The answer is, obviously, yes, unless you change your approach to cities in toto. Which is to say, yes, CDBG is very effective money, and we use it well, and the other programs we try to do as well.

But every one of those programs you have a Federal bureaucrat tell a State bureaucrat tell a local bureaucrat tell a neighborhood person how to spend their money. If you replace those programs with sufficient tax credit so that is an advantage for people who live in urban cores, then we could do it. If you keep the tax situation the way it is now, take away the help for the folks who are poor, you will leave the cities with a foot in each world.

Mr. KLECZKA. You have mentioned that on a couple of occasions this morning. You have read the Contract as well as all of us. That is not part of the Contract. Those specific types of breaks are not there. So know full well you are not going to get the things, as I see it, which are the most beneficial because of the broadness of the way the tax cuts are written, but some of the downfalls that are coming—are coming, come hell or high water.

I have to assume that we are going to pass the balanced budget amendment.

And then the question I asked or in the statement I posed to Governor Weld, I think what we are doing here, my friends, is shifting the shaft. And as a former State legislator we did it to the cities and the counties. Now, as a Federal legislator, I am going to be mandated to do it.

And the downfall for me is to become popular at home because I have cut the Federal deficit and cut taxes. And so, my friends, I—in a couple of years, if I am still around, I will be the hero. And the State legislators and Governors of the country and mayors such as you are going to be the villains.

And I see no protection for you. Because at the end of the day, at the end of this entire period, my friends, the people still live in Indianapolis, they still live in Philadelphia, and they still will be living in Milwaukee. They are not going to traipse out here to make their case. They are going to go to city hall with their signs.

If, in fact, the proposals did the things—and as a strong proponent of empowerment zones and enterprise zones, if the proposals were specific in that area, you are right, and these things will happen. But that is not the way it is geared.

Mr. RENDELL. Well, let me say, number one, I agree with you. If the balanced budget amendment requires the cuts that you are talking about, then it will be——

Mr. KLECZKA. By the year 2002 it is 1.73.

Mr. RENDELL [continuing]. Then it would be the greatest unfunded mandate of them all, the mother of all unfunded mandates. There is no question. But, as I think Congressman McCrery said, the Contract is not written in stone.

We are very hopeful—we are going to send you all of our tax incentive ideas, and we are hopeful that we will get that in, and we are hopeful that when you go through it you will go through it with an application of common sense and that the Democrats and the Republicans can get together and do some significant things.

Like I saw in the Contract—and we didn't go too far on this because the reinstitution of Star Wars which would rob us of money for the programs we need—I heard the testimony on Star Wars, that it would destroy 95 percent of the missiles launched on American targets. If 100 missiles were launched on Philadelphia it would destroy 95 of them, which means 5 would get through. Which would mean that I, sitting in city hall, you could put me in a thimble. I don't think I want to spend money on that when people I represent don't have money for heat.

Mr. KLECZKA. Mayors—and I am talking to both mayors—great job. And we appreciate you coming down today. Thank you, Mr. Chairman.

Mr. CRANE. Well, I want to express appreciation to both of you for your testimony and participation today.

One final question, though, if I may.

Mayor Rendell, when you first took office, my understanding is Philadelphia was in a kind of critical financial state. And I am curious what you did to restore the community's confidence in the business community and others in Philadelphia immediately after taking office.

Mr. RENDELL. Well, I think the first thing I did, even before taking office, during the campaign, is I told people the truth. I told them that we were in worse than critical shape, that we had one and five-sixths foot in the grave, and unless we were willing to do very difficult things to reform the way we operated that we were done for.

And then we set out. We renegotiated contracts—didn't renegotiate, the contracts came up. We had some very bitter fights with our unions, and they were unfortunate, but we did render tremendous concessions in the benefit package that saved us almost $0.5 billion over a 4-year period. We got tremendous concessions in non-economic things that enabled us to manage the government more effectively. And then we went out and examined everything that we did as a government, just like Mayor Goldsmith has done, and he has been the leader in America.

We did competitive contracts or privatized 23 services, saving $32 million a year. We went out and hellbent for leather decided we were going to collect every dollar of taxes out there not being paid. We didn't raise taxes, but we went out there, and we now collect $70 million more a year than we did before.

And we have reviewed everything we did as a government—downsize, rightsize. We have about 1,200 less employees out of 25,000 than we did. And all of that amounted to in 18 months we took a budget deficit of $450 million and turned it into an itsy-bitsy $3 million surplus. And last year we had a $16 million surplus.

But it wasn't easy. And people were ready for it because we told them the truth, and we told them what we had to do, and we told them what the payoff was at the end.

Mr. CRANE. I salute you both for distinguished performance. Mayor Goldsmith.

Mr. GOLDSMITH. I think, just to punctuate Mayor Rendell's comment, is something that I feel is at least helpful to point out. Budget reductions don't mean service reductions. And competition and private enterprise will cause better, higher quality and more services to be delivered.

Our budget is down in real dollars. Our employee force is down 35 percent, and our services are up. And to allow the dialog to be if you cut a budget you will cut a service is not true. And I think that these cities show that this Congress can dramatically make a change without incurring great loss in services to the people of America.

Mr. RENDELL. And the two of us are not alone. I think mayors all over the country, Republicans and Democrats alike, are doing similar things. And it can be done. I mean, one of the biggest problems we faced is I was a city that had strong labor contracts and civil service system. We have created an incentiveless system for our work force. And I think that is probably true to a great degree with the Federal work force. How do you get incentives back in? How do you get that free enterprise system to work for your workers and motivate them?

Privatization has helped because the workers who haven't been privatized—and they are the vast majority—they are scratching their heads and saying we better get together with our managers and cut costs or both workers and managers are going to be privatized out of a job.

And we tried to put in incentives for productivity. And I didn't get it in my last union contract, but if I am around for the next one I want to get the ability to give bonuses for good performance and employee suggestions that save us money.

You remember that lady in Massachusetts who came up with a suggestion that saved them $189 million? I think she got a couple of days off and a letter from the Governor. And that is great.

But can you imagine if for the first year of any cost-saving suggestion that came from a Federal employee—for the first year of that cost savings that Federal employee got 10 percent of the savings rendered with say a cap of $50,000? Can you imagine the ideas that would come from your Federal work force for how you could save money?

Mr. CRANE. Well, I would remind you a former resident of your city, Mayor Rendell, Benjamin Franklin said a good example is the best sermon. And you are both shining examples, and I thank you for your testimony today.

Our next panel is Eloise Anderson, Perry Moy, Dale Kettler, and Robyn Klapperich.

Well, as we prepare to commence here, let me acknowledge one of our guests is a former constituent of mine, Mr. Moy. Mr. Moy is a living example of what opportunity, hard work, and commitment can do in the way of guaranteeing success. And I want to welcome you, Mr. Moy, even though I lost you as a constituent with reapportionment.

Mr. MOY. We miss you, Congressman.

Mr. CRANE. I look forward to visiting your restaurant in the very near future.

And I would like to yield to Mr. Camp to welcome also another one of our guests.

Mr. CAMP. Thank you. I want to welcome Dale Kettler, who operates a family farm in Chesaning, Mich., right in the heart of the Saginaw Valley in Michigan. His farm was started by his great, great grandfather, a Civil War veteran in 1878, and is about 500 acres of cash grains—corn, soybeans and wheat.

I have known Dale for some time. He is active in local agriculture as well as serving on various State agriculture committees. He has driven here all the way from Michigan. I know his wife Nancy is here, and two of his children came to hear his important message.

Dale is a farmer in middle America who knows what it is like to work hard, make ends meet and keep the family tradition alive. He is one of the real people that government must hear from in order to appreciate how high taxes are, how out of control spending is and how bureaucratic overregulation can harm a very important industry to all of us, the agricultural industry.

Thank you, Mr. Chairman.

Mr. CRANE. Thank you.

And now we will start with Ms. Anderson and then work to the right from your perspective.

STATEMENT OF ELOISE ANDERSON, DIRECTOR, CALIFORNIA DEPARTMENT OF SOCIAL SERVICES, SACRAMENTO, CALIF.

Ms. ANDERSON. Thank you, Mr. Chairman and members of the committee, for inviting me here to talk about the Contract With America.

I am Eloise Anderson, the director of the California Department of Social Services, and I am responsible for AFDC, child welfare, Social Security programs, disability evaluation and in-home supportive service. My experiences go back to the fact that at one point in time, 30 years ago, I was a socialworker in a community organization.

I would like to summarize my remarks and have my written testimony that you have be put into the record so that I can keep within your time limit here.

When I look at the Contract With America what I see is accountability. And I have been in this field for about 30 years, and I will say to you that accountability is surely lacking, especially in social services programs. So I am very excited about the fact that we are talking about accountability.

I also—in the past 30 years, I have begun to believe that the private sector can do much of what the public sector does now. And I come from the position that if people didn't want to buy our services maybe we shouldn't be providing them. And that at one point in time most of the social services that we provide now were done by the private sector.

I also, over 30 years, have begun to look at AFDC and other social service programs as injuring family stability and family formation. And the programs that we have put in place have ignored the importance of fathers, discouraged personal responsibility, and they take too much from family income to finance the good intentions of government.

I am not a tax expert. I am not a defense expert. And I am not an academician, but I think I have practical experience and some administrative experiences in this field.

Please—and I underline please—fulfill the promise to restore flexibility to the States, to develop innovative, effective and affordable solutions to our many service problems.

I have now worked for two Governors, one, Tommy Thompson of Wisconsin and the other, Pete Wilson, presently. What I have seen with these two Governors is that the waiver process that we must put our States through has been incredible. And even after we get the waivers and we do good with those waivers, one thing is for certain that they are not permanent. So no matter how good they are we may need to revert back to our old ways of doing things.

We in the State understand that when you give us taxpayers dollars you need to hold us accountable. We are not asking not to be held accountable, but we are not asking to be held accountable for a process. We need to agree on outcomes.

We look forward to a block grant. We need flexibility, designed programs that meet the needs of our residents. The current system, the relationship that we have between the Federal Government, State government, seems to be one devoid of trust. It seems to us that you don't trust us to do what is best for our citizens.

I guess the next question one would ask is what we would do with flexibility? Well, having now worked in two States, I will tell you that States are different. They are not only different geographically, they are different demographically. They have different economic bases, but they are also institutionally different, culturally different and politically different. So I suspect that many of the States would do very different things.

But I also think that one size does not fit all, and we need to try to quit making programs that fit all people.

But I think that there would be lots of things that we would do similar. Especially when I look out and see the programs that are across the States in terms of their waivers we have a lot of things that are similar.

But I think there is one thing that we would all do and that is that we would not assume that people on AFDC are helpless. We would stop treating AFDC recipients as if they were victims that need to be taken care of. We would stop having the State play the role of husband or father or parent. The attitude is demeaning, and the attitude fosters dependency.

We believe that we need to create better incentives and different modeled programs to help people get out of the cycle, programs and policies that give incentives to do a couple of things. The importance of fathers—what this program has done, and I have watched it over 30 years, is marginalize poor men. It makes men at the low-income level redundant.

One of the things that I think States would do is that they would redesign the child protection system. They would make their child protection programs child centered and family focused. So as you are looking at this block grant we suggest that you also put child welfare funds into the block grant.

When we look at teen parents I believe that the States would come to that to try to deal with the issues, but I don't believe that the issues of teen parents is an income transfer problem. I believe it is a child protection problem. I believe for the past 30 years that government has sponsored child abuse in how we treat teen parents.

Give us flexibility in the funding to address these issues, and we will do it. We are up to the challenge.

Thank you.

[The prepared statement follows:]

TESTIMONY OF ELOISE ANDERSON
DIRECTOR OF THE CALIFORNIA DEPARTMENT OF
SOCIAL SERVICES
BEFORE THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
JANUARY 12, 1995

Thank you Mr. Chairman and Members of the Committee for inviting me here today to talk about the "Contract with America." I am Eloise Anderson. I am currently the Director of the California Department of Social Services. This Department administers the AFDC, Child Welfare, Foster Care Systems, SSI/SSP, and In-Home Supportive Service programs in the State of California. In addition to my policy and administrative experiences, I also have hands-on experience as a social worker in a community agency.

First, let me say that I am thrilled to be able to talk with you about the Contract because I believe that the Contract heralds a new approach to government, one that I have waited for since I became of voting age in 1963. We, the people, will be served well by the direction that the Contract outlines. The approach of the Contract will put us in a position to face the challenges of the next century, hopefully as a united people where all who put forth the effort can benefit. I think the Contract is about government accountability, especially federal government accountability. We must increase accountability in all programs including welfare. I also agree that we should shrink the size of government at all levels; too many of our problems have grown beyond our ability to support them. The Contract is also about families, and for over thirty years I have witnessed the disparagement of families by government programs that ignore the importance of fathers, discourage personal responsibility, and take too much of the family's income to finance its good intentions.

I am not a tax expert, I am not a defense expert, and I am certainly not an expert in Congressional rules, so I want to focus my remarks on what the Contract could mean for social service reform.

First, however, I want to briefly talk about our approach in California. In California, Governor Pete Wilson has proposed over the past five years comprehensive reforms to our State's welfare system. These reforms--some of which have been enacted and are now being implemented--are built upon the following principles:

- Programs to help needy families should reward activities that lead to success: work, saving and staying in school
- They should not reward having more children
- They should not allow teenagers to set up households when they cannot support themselves
- They should rely on real jobs as the key to leaving welfare and getting out of poverty
- They should be based on mutual obligation, by which recipients have partial responsibility for supporting themselves and their families.
- Reform efforts should result in no new costs for the federal government, and should achieve State savings.

Our State's welfare reform principles are a clear example of why I believe that the most important and promising statement in the Contract concerning social welfare is, and I quote, "The best welfare solutions come from the States, not Washington, D.C." I urge you to remember this as you develop your social service reforms this year. As you know, this country was founded upon the principle of Federalism, in which the States were seen as the laboratories of democracy. No matter what else you do, I urge you to renew the commitment of our founding fathers to Federalism. By doing so, you will fulfill the promise of the Contract to restore flexibility to the States to develop innovative, effective, and affordable solutions to our many pressing social problems.

I have been privileged to work for two Governors--both very committed to welfare reform. Yet, both Governor Pete Wilson of California and Governor Tommy Thompson of Wisconsin have had to squeeze their considered reforms of the welfare system through the tiny and twisted portal of the federal waiver process. This is a process that makes States stand on our heads to get permission to try to implement needed reforms, and even if we demonstrate that our reforms work, there is no guarantee that they will be adopted as permanent changes. Indeed, if the States required the federal government to demonstrate that its welfare reforms worked before they could be imposed on the States, we would not have the broken welfare system we have today.

The Contract gives us an opportunity to redefine the role of federal and state governments in social services. We, at the State level, realize that you have an obligation to hold us accountable if you pass tax dollars to us. Through block grants you can hold us accountable while still giving us the flexibility to design programs that meet the needs of our residents. The current system seems to me to be void of trust. It is as if the federal government does not trust the States to do what is in the best interests of our citizens.

What would States do with this new flexibility? Moving from Wisconsin to California a few years ago has taught me that there are incredibly significant differences between States, not just in demographics and economics, but also in institutions and politics. These differences would mean different designs in a system that provided states with flexibility and also held us accountable to better results. I suspect many of us would use the new flexibility in similar ways.

Many of us would redesign programs that do <u>not</u> assume that the people we serve are helpless. The current programs, AFDC in particular, treats clients as victims and patronizes them by "protecting" them from the real world, as if the State is the husband (in the traditional sense) or parent. This attitude is demeaning and it fosters dependency. Most adults on AFDC are quite able to help themselves, and would--if the disincentives of the current system were eliminated. Under Governor Wilson's leadership in California, we have made great progress in building a work incentive into our AFDC program, and with additional flexibility, we could implement the Governor's proposed two-year limit on aid to able-bodied adults. This additional reform of time-limited aid would not only greatly increase the incentive to work, but would also send the very important message that welfare is intended to be temporary assistance, not a way of life.

Many States would also design programs that recognize the importance of fathers in families. The present system marginalizes poor men. It makes them redundant. I have watched far too many women "marry" the State through the AFDC program. The State makes a poor husband, and a worse father. Again, as part of Governor Wilson's vision, in California we have already implemented a number of reforms designed to restore the role of the father and with additional flexibility we will do more. The rights and responsibilities of fatherhood cannot be deferred simply as financial; in California we have begun a campaign called "Focus on Fathers," that will heighten awareness of the role of men in the development of their children.

If given the flexibility to do so, many States would redesign their child protection systems to be child-centered and family-focused to assure better outcomes for kids. The current funding mechanism is designed to encourage placing children in the most restrictive care. Governor Wilson has just announced a major reform of the child protection system in California with the goal of assuring safe, nurturing homes for children, providing high quality and effective services to families, and assisting children to transition successfully from government care into adulthood. One of the key elements of our reform is something we are calling "flexible funding," which allows our 58 counties to use more creatively State funds to develop better and more appropriate services at the local level. At the federal level, you could also convert these programs into a block grant and thus join us in our effort to encourage local innovation.

Finally, I believe that many States would use the new flexibility to design innovative ways of dealing with one of the major social problems of our day, out-of-wedlock teenage births. What to do with our fast growing caseload of never-married mothers, many of whom also have never worked, is one of the more vexing problems. We have all followed with great interest the recent debate on orphanages. I do not believe that this issue is an issue of income transfer, it is a child protection issue and belongs not in AFDC but in child welfare. Give us flexibility and I know that we, in California, would address this issue of out-of-wedlock teen births. In California more than 50 percent of our AFDC caseload are women who had their first baby as a teenager. They generally don't finish high-school, and they become dependent on government help. That's why Governor Wilson is again proposing to require teenage girls who have children live with their parents if they want a welfare check. But we are also encouraging these young women to continue their education through a program we call Cal-Learn. Cal-Learn rewards teen mothers who stay in school and maintain passing grades by increasing their grants. On the other hand, teen mothers who earn failing grades, or who drop out of school, have their grants reduced. I think this is a very wise approach because it gets the States out of the business of setting girls up in their own apartments who are vulnerable and emotionally, financially, and educationally unprepared for life, and who begin parenting without social supports. Many do not feel that being a teen mom is a problem because of many of our grandparents were teen moms. Mine was, but that was in the early part of this century and the latter part of the last one. Life was different. Not finishing high school or even going to high school did not have the severe economic consequences that it has now. We live in a society in which a high school education, and even post-high school training are increasingly important in competing for the kinds of jobs that can provide long-term self-sufficiency. Children have always benefited more in a two-parent family than in a one-parent family. I firmly believe that the AFDC program is anti-poor fathers, and has driven more men away than we want to admit. Raising children alone has always been a risk factor for poverty. Society should encourage teens to delay parenting. We should not foster children having children. Finding good alternatives to welfare to the problem of out-of-wedlock teenage births will certainly be a challenge to all of the States, but we are ready for this challenge. Let the laboratories of democracy tailor the solutions to this very complex problem, which will make sense given each State's demographics, economics, institutions, and politics.

As a citizen, I am excited about the prospects for positive change that the Contract With America heralds for our nation and I wish you luck as you start your work to put these changes in place. As a State administrator, I am very hopeful that the Contract will give States the flexibility to implement reform in programs where real reform is long overdue. Thank you for allowing me to address you today.

Mr. CRANE. Thank you.
Mr. Moy.

STATEMENT OF PERRY MOY, OWNER, THE PLUM GARDEN RESTAURANT, MCHENRY, ILL.

Mr. MOY. Mr. Chairman and members of the committee, thank you for inviting me here today.

My name is Perry Moy, and I own the Plum Garden Restaurant in McHenry.

I would like to explain a little bit about myself to you. Restaurants are in my blood. My father came to Minneapolis from China at age 8, a very small boy seeking economic opportunity. He worked at his uncle's restaurant, literally sleeping in the kitchen, until he was 21 years old.

Like so many of his generation his plan was to return to China. He stuck to his plan, at least in part. He did go back, meet my mother, and marry. But as a naturalized American citizen he was called back by the draft and ended up serving in the Pacific front and in the occupation of Japan.

Soon after, I was born. My mother and I traveled to this country, and it turned into a lifetime. The Communists overtook China, and we were left here and couldn't get back in. Then my dad's unexpected death left my mother with three small children and no livelihood, so we set about creating a life.

I was 7. I began working alongside my mother in my uncle's restaurant in Park Ridge, Ill., washing dishes, sweeping, and answering the phones. Ten years later, with $4,000 in savings, my mother and I boarded a train. We stopped at the last stop, and it was a town called McHenry. We found a small storefront, paid $60 for the first month's rent and opened up a carryout restaurant.

In the same spot of the first Plum Garden, the carryout my mother and I started 30 years ago, I now own an 80-seat fine dining restaurant specializing in creative Cantonese cuisine. We employ 32 people, many of whom have been with me for more than a decade. Our restaurant is an important part of our small town, and I am very proud of what we were able to do.

I am not an expert on welfare or tax policy. I am here today to give you one citizen's perspective on the spirit behind the Contract With America.

Obviously, I am a big believer in the work ethic, in the free enterprise system and in economic opportunity. Hard work has been the rule for me. That is one reason why I believe so strongly in the kind of changes you are talking about for the welfare system, changes that emphasize work over long-term welfare dependence.

A number of my employees are single moms making a transition off welfare. I recognize in them the same desire I saw in myself years ago: The desire to better themselves, to provide for their kids and to get ahead in life.

I believe there is a fundamental dignity and a value in holding a job. Wherever you start out—a dishwasher, a fry cook or barperson or whatever else—I speak from personal experience in saying that the restaurant industry gives you a start as well as a career path if you want it. Any changes Congress can make in the system to foster the work ethic will take us down the right path.

I also support provisions of the Contract that would make the free enterprise system work more efficiently. Cutting the capital gains tax, for example, is a terrific idea. Ultimately, I believe that will direct capital in ways that make the most economic sense and will get away from penalizing people that make money.

I support, too, tax changes that make businesses more willing to invest in the equipment we believe will make us stronger and more competitive, giving us more confidence to invest, knowing these investments will yield long-term benefits.

The small business expensing rules and the proposed neutral cost recovery proposals especially would assure us that the Tax Code would allow us to depreciate 100 percent of the purchase price of an asset. This is an important consideration as we try to upgrade our equipment.

Liberalizing the estate tax rules is a good idea as well. Ninety percent of Chinese restaurants are "ma and pa" operations. My wife and I have three small children. Along with millions of other American moms and pops, we would love to see them become doctors, lawyers or even Congresspeople like yourself. But my piece of the American dream is the Plum Garden, and I would like to give the restaurant to my kids at the time when the time comes and not have to make them suffer for it.

I guess what I am saying is that in the real world we feel the impact of what goes on here in Washington. For example, when Congress cuts the tax deduction of meals to 50 percent, I see the impact—fewer businesspeople in my restaurant. When Congress raised the FICA tax on tips in 1988, I was out thousands of dollars for higher payroll taxes.

So as you develop tax policy over the coming weeks, keep people like me in mind. Think of an 18-year-old boy and his mother, life savings in hand, and trying to start a new business.

Thank you very much, Mr. Chairman.

Mr. CRANE. Thank you, Mr. Moy.

Ms. Klapperich.

STATEMENT OF ROBYN KLAPPERICH, SAN ANSELMO, CALIF.

Ms. KLAPPERICH. Good afternoon. My name is Robyn Klapperich and I live in San Anselmo, Calif. I have been a secretary at the Marin Primary and Middle School in Marin County for the past 3 years. I would like to share with you my family's experience in taking care of my elderly mother, Meredith McKendry.

Ten years ago, after my father passed away, my husband and I decided my mother should come and live with us. This seemed like a perfect arrangement because I am an only child and my mom is handicapped. She lost her leg to bone cancer and has worn a prosthesis for 38 years.

Approximately 6 years ago, my mother's financial advisor recommended an AMEX Life long-term care insurance policy for my mother. He discussed it at length with both my mother and me and said he was recommending that his mother get one also. At the time, my mother was in good health and we hoped we would never have to use the policy, but we felt it was such a good idea she signed up for it.

Four years ago, we began to notice subtle changes in my mother's behavior. She was becoming very forgetful, easily confused and had difficulty paying her bills. Most frightening of all, she couldn't remember how to start her car. She asked my son to write directions on how to start the car so she could tape them to the dashboard. She was also experiencing hallucinations.

These changes didn't happen overnight. It was a gradual process. I began making doctors' appointments to see if there was something we could do to help her. Unfortunately, there was nothing we could do but watch her deteriorate. It was very painful for all of us to watch a woman who had been so strong and independent failing. My mother had volunteered at the local hospital 2 days a week, played bridge and gone to the movies and out to lunch with friends. Gradually, that all ended. She was as frightened by what was happening as we were.

One morning we discovered that my mother had fallen during the night and had severely burned her arm on the wall heater. It was at that point that I realized that I needed to have someone come in to help take care of her. It seemed that our roles were being reversed. I was feeling like my mother's mother. She needed help brushing her teeth and getting dressed, things I had done for my children but never dreamed I would have to do for my mom. At one point she even said, as I was dressing her, "I can't believe it has come to this."

I was lucky because in our area there was a group called Senior Access that finds help for the elderly and ill. Through them, I found a wonderful young woman who was going to school to be a nurse. She was with my mom 4 hours a day to begin with, and as my mother's mental health deteriorated, she stayed 8 hours a day. At the time my mother purchased the policy, home health care coverage was not available so the insurance did not cover any of this cost. At that time, unskilled care cost between $10 and $12 an hour, depending on what services they had to provide.

As my mother became more dependent, I began to search for a nursing home for her. My mother's caretaker was able to give me recommendations about nursing homes in my area, which helped. My search was also made easier because I knew that my mother had long-term care insurance and I was able to look at only the finest facilities. I found a home I liked and put my mother on the waiting list.

Two years ago my mother had a bad fall and cracked her pelvis. After consulting with her physician, we decided that it was indeed time to put her into the nursing home. Putting my mother in the nursing home was the hardest thing I have ever had to do. It would have been even more difficult without the long-term care policy. I am afraid I would have had to put my mother into what I would have considered an inferior facility.

As of today, the nursing home cost for a semiprivate room in my mother's facility is $130 a day. With medication and a few extras, the cost is well over $4,000 a month. The AMEX Life long-term care policy covers $3,600 a month. The remainder I pay out of my mother's Social Security and retirement.

We have two children in college and because of this policy we did not have to compromise our lifestyle. I know my mother would never have wanted us to make sacrifices for her care and I am so thankful that we didn't have to make the choice between my children's education and a nursing home for her.

As my generation looks forward to living longer, the problem of care for the elderly will become more severe. There is an enormous need for this kind of insurance. Most people are not aware of the high costs involved. I think people need to be educated and provided with incentives to take care of themselves.

I have been told that the Contract With America, in particular the Senior Citizens' Equity Act, would provide some tax relief and clarification for people in circumstances similar to mine. I also understand that the Family Reinforcement Act which would provide a tax refund to families taking care of elderly parents or grandparents would be very helpful. Anything that could be done to help would be very appreciated.

I would like to thank you for giving me the opportunity to testify today.

[The prepared statement and attachment follow:]

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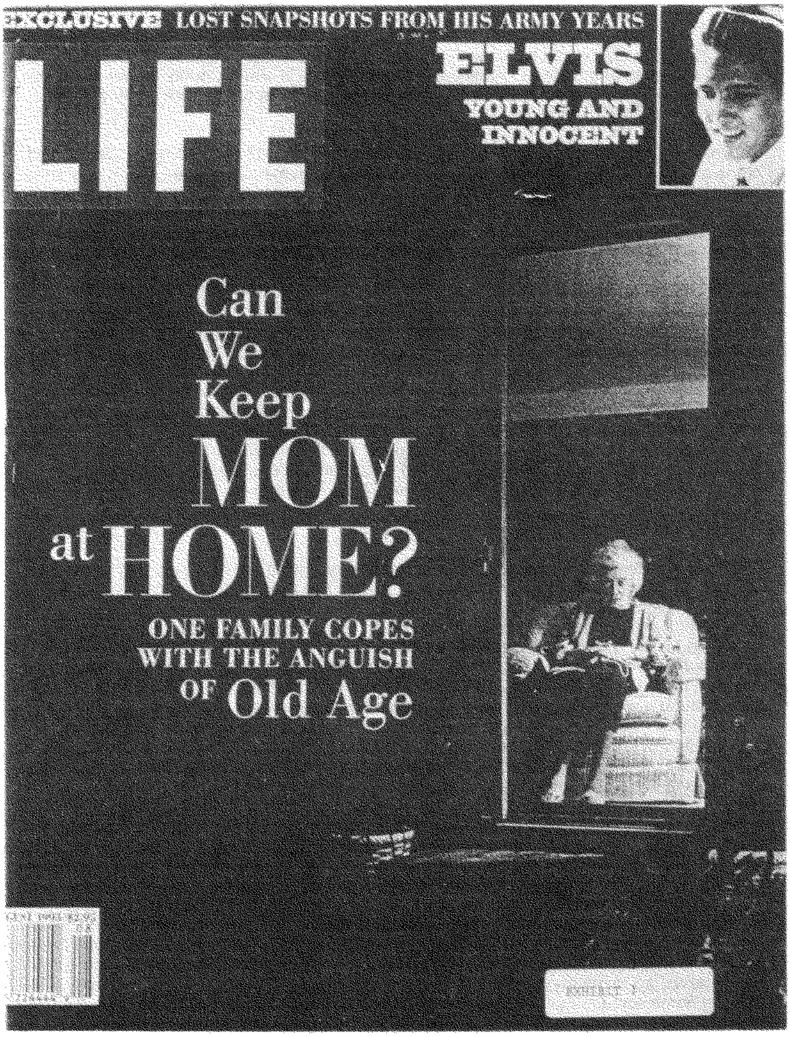
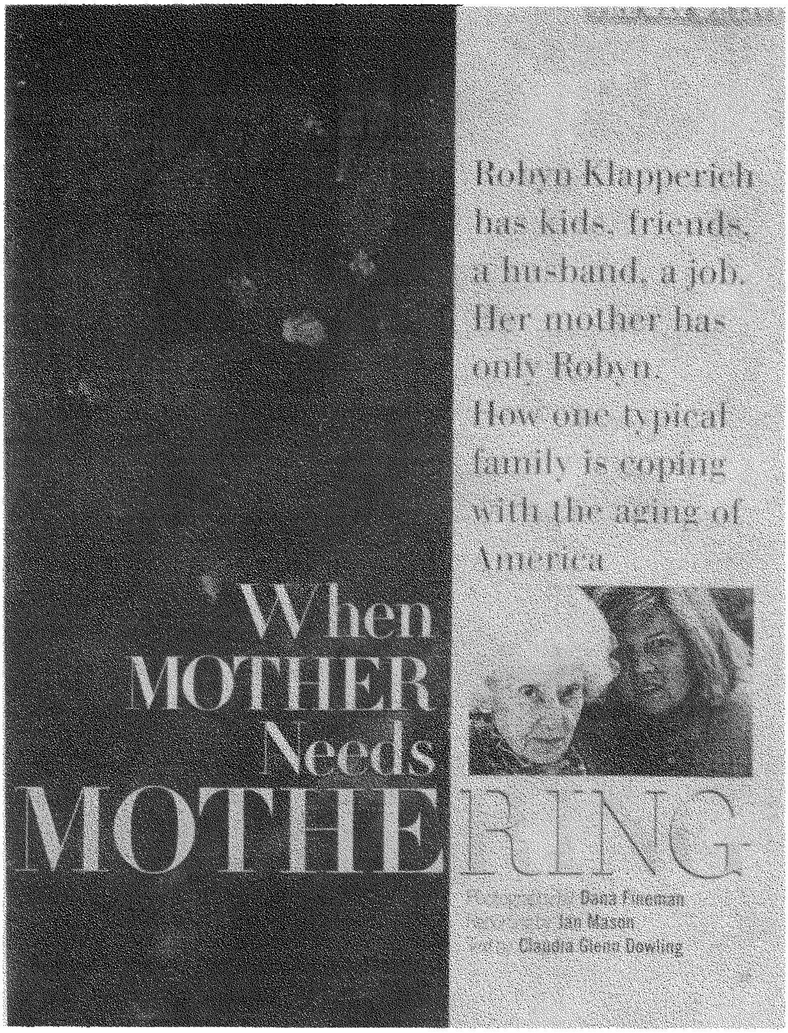
I'd like to thank you for giving me the opportunity to testify here today.

Reference: LIFE Magazine, August 1993, Pages 29-36.

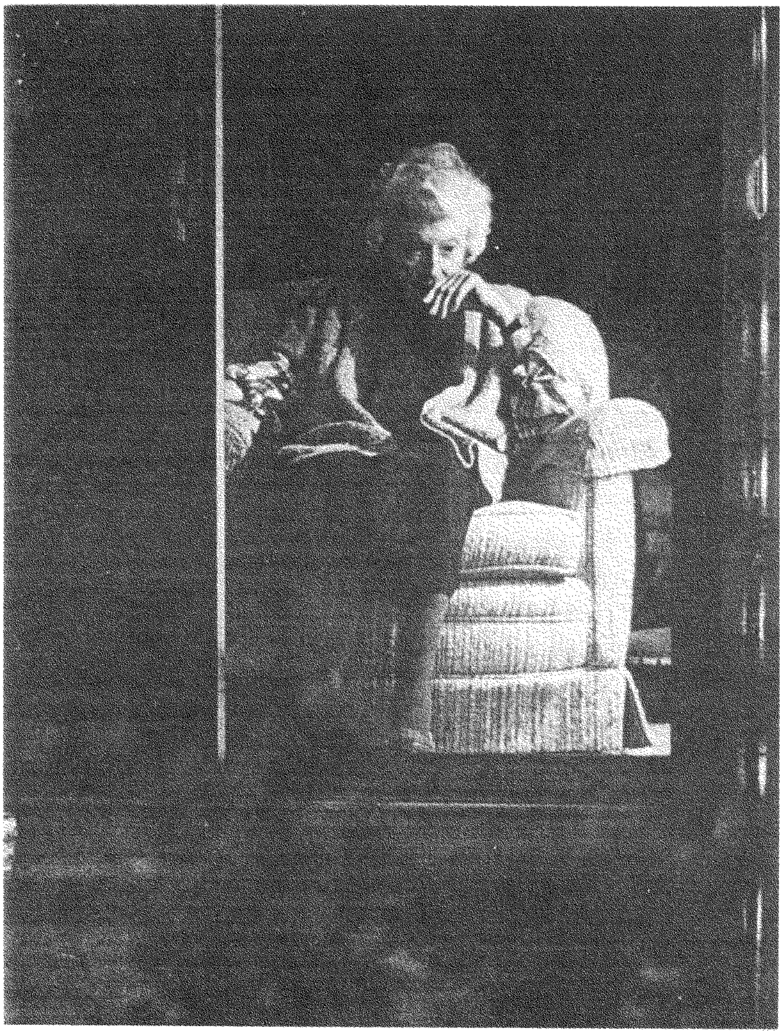

EXCLUSIVE LOST SNAPSHOTS FROM HIS ARMY YEARS
LIFE
ELVIS
YOUNG AND INNOCENT
Can We Keep MOM at HOME?
ONE FAMILY COPES WITH THE ANGUISH OF Old Age



Robyn Klapperich has kids, friends, a husband, a job. Her mother has only Robyn. How one typical family is coping with the aging of America

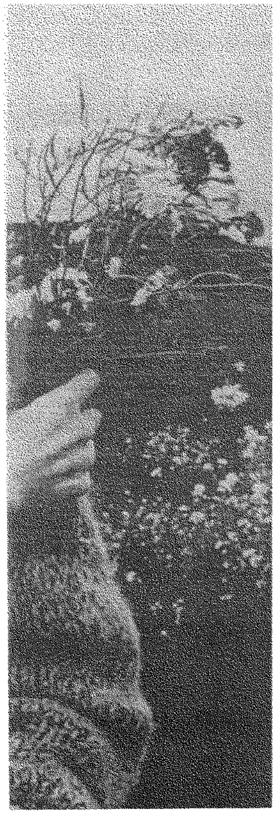
When MOTHER Needs MOTHERING

Dana Fineman
Ian Mason
Claudia Glenn Dowling




I never wanted to live with my daughter. When she has to do somethin

for me, I get upset. But I'm so lucky to be surrounded by this family."



Eight years ago, soon after her father died, Robyn Klapperich realized that her mother, Meredith McKendry, then 73, could no longer live alone. Robyn (an only child) and her husband, John, a municipal water supervisor, bought a house in Marin County, Calif., with a separate mother-in-law apartment. "Mom wanted her independence," says Robyn, now 46, a secretary in a private school. "She said she didn't want a bedroom in *my* house, but if she had her own place, fine." The arrangement worked for five years: Meredith had her family nearby—and her grandchildren had someone to drive them to town—and she also had her own friends, her volunteer work at the hospital (6,957 hours of service as a Pink Lady), her life. Then Meredith became forgetful. She couldn't find her wallet, keys, the address book she had wrapped up in aluminum foil and put into the refrigerator. In 1991, shortly before *LIFE* first visited the Klapperich home (we went back twice after that), she asked her grandson to tape to the dashboard a reminder of how to start her car. Her family made her stop driving, a deeply symbolic loss of independence. And then there were the falls. Once, Jimmy and his sister, Katie, found her out cold. They called 911 and then their mother, who got home to find the kids crying in the driveway. As their father recalls, "They saw that Grandma is mortal."

Meredith helps her grandson, *Jimmy*, dress for the prom *(below)*. "She used help me with everything," he say "Now, some nights, sit and wonder if she's all right. I go over, see her sleep and go back to bed

John Klapperich helps his mother-in-law to her room when she gets too tired *(right)*. "I love the lady," he says.

"I wasn't exposed to what later life is like," says aide Kate Reichling, 25, walking by the Pacific with Meredith *(left)*. "It's built my compassion."

"I give Mom as much as I can—she deserves it. But I've got a life."

Katie *(foreground)* is home from the University of California, Davis; as family and friends gather for a cookout, Meredith watches from her room.

At three a.m., on a summer night two years ago, the phone rang. John answered. "Oh, John," said Meredith, who had been watching tennis on TV. "Martina Navratilova has fallen asleep on the couch. I couldn't wake her, so I put a blanket over her." John shook his wife. "Robyn," he said sadly, knowing it was another night she would come back to bed in tears, "it's for you."

"Do you think I'm losing my mind?" Meredith asked anxiously after several such episodes. Doctors couldn't diagnose the hallucinations but suspected that better nutrition might reverse Meredith's increasing dementia. Robyn began fixing her mother breakfast before work. An aide took over during the day. In the evenings Robyn prepared her mother's dinner, her family's dinner, did the laundry and dishes, packed lunches. Robyn and Meredith had always had a good relationship, the kind where they spoke every day because they *wanted* to, but now Robyn felt squeezed between her mother and her family. "I wasn't so much getting angry with my mother as with the situation," Robyn says. "I wished I didn't have to worry about her. But that felt so selfish." A support group she found through Marin Senior Services helped Robyn deal with her guilt. She vowed not to be a martyr: "It's O.K. to have my own life—my mother had hers." ➡

Debilitating illness leads to short tempers: Even cookie baking can turn into a confrontation.

TO EVERYTHING THERE IS A SEASON

In tasteful rooms of aqua and mauve, elderly ladies and a few men sit in wheelchairs or lie on their beds, staring at the light. Meredith rubs her thin hands together and smiles vacantly, maundering about the past. "These people are never going to get better," Robyn remarks. "Friends say to me, 'You're saying your mom should die?' And I really wish she would. Quickly. A stroke or a heart attack." It has come to this: Many find a sudden death preferable to a slow dying, a painful old age. Robyn visualizes Jimmy and Katie caring for her and says, "Dr. Kevorkian. The home kit. I will not do this to my children." The concept of hastening the end may horrify, but at the moment it is one of the few alternatives proposed for the enormous emotional, physical and financial tolls levied on the terminally ill and their families. With more people living longer than at any time in history, other solutions are desperately needed. In 1990 there were 31 million people over the age of 65 in the United States—12.5 percent of the population; the federal government's Medicare program spends more than $145 billion a year on health care for the elderly. When Robyn's generation reaches her mother's age, a fifth of the population will be old, and the costs are projected at a staggering $4.1 trillion annually. As Hillary Rodham Clinton's health care task force has heard over and over, now is the time to do something to avert fiscal disaster.

"I wish she was like she used to be, but she's not," says Robyn, who visits her mother, 81, every day. John and the kids visit several times a week. When the aide who used to care for her came by, Meredith asked her to call Robyn to "get me out of here."

Caring for the aged has traditionally had as subtext the Fifth Commandment: Honor thy father and thy mother. At the end of their parents' lives, children repay the years of care they received. This is still the norm. Four out of five disabled elderly people in the U.S. are cared for by relatives, three quarters of whom are daughters. The stresses on this "sandwich generation"—those with children and parents to provide for—have given rise to highly publicized incidents of "granny dumping," in which old people are abandoned at hospitals. But even the vast majority of Americans who happily care for their parents worry about the emotional and financial strains of long-term senility.

Meredith's financial adviser had persuaded her to take out nursing home insurance, which will cover her care for the rest of her life. But such forethought is atypical, and costs can run as high as $60,000 a year. The alternative is to "spend down," or divest oneself of savings, to qualify for state welfare programs like Medicaid. This year New York State passed a groundbreaking law mandating that the state pick up the tab after three years of privately insured care, even if there are still untouched savings.

But there are not enough beds in the nation's nursing homes—at last count only 1.6 million—and the wait can be several months. Networks that coordinate such services as day care, transportation and meals sustain some people at home. Those who can afford it may buy into continuing-care facilities, condominiumlike setups that provide increasing levels of assistance, from cleaning and cooking to feeding, toileting and medical care. "I'm going to sign myself up for one of those places," says Robyn. "They play bridge, have little outings. It's a way to make new friends." Demand, however, far exceeds supply, and most are unavailable to Americans without large savings or private insurance.

Meanwhile, as a generation faces their parents' decline, graying baby boomers are discovering that even they cannot buck genetic destiny. "You realize," Robyn says, coming at last to her own private conclusion, "that you are not going to live forever."

"I felt really bad because I knew she would never come home again."

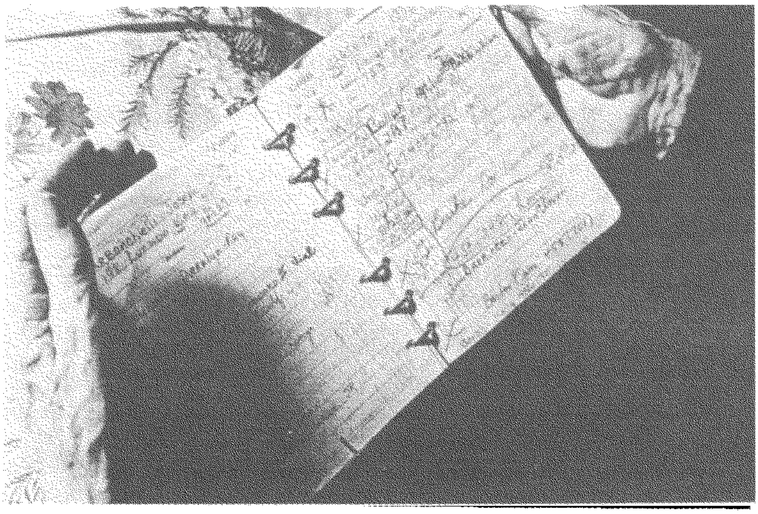
Meredith's life had become a catalogue of loss: mobility, independence, friends, faculties, personal dignity. By early 1992 she couldn't remember how to dial the phone or change channels on the TV. In lucid moments Meredith sometimes felt so infantilized that she called her daughter Mom. Robyn, too, was saddened. "The role reversal—becoming mother to my mother—was really awful," she says. "Things I didn't think I was capable of doing, I did—like changing her diapers. Sure, I changed my kids' diapers—but that's my *mom*. The difference is, the kids get older and you won't have to do it. But my mother is going in the opposite direction."

Robyn, worried about how long she could care for her mother at home, had started to look at nursing homes when, in February of this year, Meredith had another fall. She cracked her pelvis and couldn't stand. The accident precipitated the inevitable. "The kids and I became the supporting cast," John remembers. "It was down to Robyn and her mother." Robyn tried to be matter-of-fact about the admission to a nearby nursing home—a 70-bed facility that was well staffed, attractive and "didn't smell bad." She explained to her mother that she could get physical therapy and better care for her bedsore there. On the day of the move, Jimmy went to school as usual, John to work, but the house seemed terribly empty when they got home. ➡

Meredith is unable to move around, so Robyn must bathe her, give her pedicures and cover her with lotion *(left)*. "I try to stay calm and take it one day at a time," Robyn says.

In the past year Meredith has lost a dozen of her closest friends; everyone listed on these pages of her address book is gone. "Your world diminishes when your friends die," says Robyn.

"What's hardest is doing things for my mother she used to do for me."



Chairman ARCHER. Thank you.
Mr. Kettler, please.

STATEMENT OF DALE KETTLER, CHESANING, MICH.

Mr. KETTLER. Thank you, Mr. Chairman.

My name is Dale Kettler and I live with my wife and four children near Chesaning, Mich. I am pleased to be a constituent of Congressman Dave Camp, who is a member of this important committee. I operate a 500-acre family farm producing corn, wheat, and soybeans with my father and brother-in-law. The farm we operate is a designated centennial farm, having been in the family since 1878.

I am a farmer. That is not what I do as much as it is what I am. I live on the land first bought by my great-great-grandfather, a German immigrant and a Civil War veteran. I live in the house that he built. So you see, farming is more than a job and much more than a career to me; it is my culture and my way of life.

I would like to thank the Ways and Means Committee for allowing me to express my views on the Contract With America and the impact it will have on agriculture.

As an individual who for several years has been concerned about the direction our Nation has been going with tax and spending policy, I am excited about many of the provisions contained in the Contract With America. I will limit my comments to those provisions which I believe are within the jurisdiction of the Ways and Means Committee.

First, the provisions for capital gains tax reform are very important. Our family farm operation has a large investment in land and equipment. As a farmer, I do everything possible to minimize the wear and tear on my tractors and other equipment. Yet when it is sold to purchase new or replacement equipment, it is possible to receive more than the original purchase cost due to a combination of good maintenance and inflation.

Currently, I am taxed at 100 percent of the gain from the sale of such assets, much of which is due to inflation. This serves as a disincentive for me to sell these assets and replace them with new equipment. This in turn affects the activity of related businesses such as equipment manufacturers, suppliers, distributors, and local dealers. The 50-percent reduction of capital gains income from tax and indexing the purchase price of assets for inflation would be an important economic boost for our family farm.

Second is the provision which increases the Federal estate tax exemption from the current $600,000 to $750,000 and indexes it for inflation. Let me use our small family farm operation to illustrate the importance of estate tax reform. The 500 acres, buildings, equipment, and other assets we own easily exceed $600,000 in value. I can assure you this value does not mean I am wealthy from a financial standpoint as evidenced by the fact that I have an off-farm job in order to raise my family in an adequate lifestyle.

However, if I were to die and leave the farm to my spouse and/or children, the current $600,000 exemption would leave them with the likelihood of being forced to sell all or a portion of the family centennial farm just to pay the estate tax. I believe it would be a shame if our farm that has been in the family since 1878 had to be sold to outside individuals or split up because of the estate tax.

Although increasing the exemption to $750,000 would be helpful, I encourage the Ways and Means Committee to increase the exemption to $1 million and retain the inflation indexing provision.

These two taxes, capital gains and the estate tax, in their current form combine to stifle growth and productivity in my industry. Older farmers are discouraged from selling their property to younger, more aggressive farmers because of the capital gains penalty and established operations are hesitant to expand because of tax liability over the $600,000 limit. This only stagnates an industry that really needs to be vibrant and competitive in this growing global economy.

Third is the provision in the Contract With America for a balanced budget amendment. I believe it is long overdue for the Federal Government to begin living within its income, just as my family and neighbors must do. Financial sacrifice and fiscal responsibilities are not new concepts in my family. I only regret that they are new concepts here. The Federal Government must not continue to spend beyond its income and saddle generations to come with the consequences.

I believe the proposed amendment which would allow deficit spending to occur if approved by a three-fifths vote of Congress and a complete waiver of the balanced budget amendment requirement if the Nation were at war are adequate protections against the dire consequences the opponents predict would occur.

Fourth, I would like to comment on a provision that is not an official part of the Contract With America but should be given serious consideration for inclusion. This provision is a tax deduction or credit for self-employed persons for the cost of health insurance. The previous tax deduction self-employed persons were allowed to take for 25 percent of the cost of their health insurance premium has expired. This creates both a financial burden and an inequity for self-employed persons.

It is common for a farmer to pay $4,000 or more for health insurance on his family. This is a necessary business expense for the self-employed person, yet it is treated differently for tax purposes than other business expenses.

The inequity occurs because the self-employed person is treated differently than a business that is incorporated. The self-employed person gets no tax deduction for health insurance premiums. However, if the business were incorporated, the corporate entity could purchase health insurance for the family members who are now the stockholders and then deduct the cost as a business expense.

I would urge the Ways and Means Committee to correct both the financial burden and the inequity by allowing self-employed persons to deduct 100 percent of the cost of their health insurance premiums as a legitimate business expense, just like any other business.

In conclusion, I wish to commend the Ways and Means Committee for moving promptly to begin enactment of the Contract With America. My family, my neighbors, and my industry are watching closely to see if the promises made will be kept with the citizens of our Nation.

I urge you to hold true to the principles, the vision, and the mission of the Contract and keep those promises. Thank you for your valuable time and allowing me to participate in this hearing.

Mr. BUNNING [presiding]. Thank you, Mr. Kettler.

I would like to ask Ms. Anderson, your testimony states that in California more than 50 percent of the AFDC caseload consists of women who had their first baby as a teenager.

Do you support the provisions in the Contract With America welfare bill under which the taxpayers would not be obliged to pay cash welfare payments to women under 18 who have children out of wedlock?

Ms. ANDERSON. Yes, we do. But we don't consider them women. We consider the fact that they are still minors, that they are still girls. As I had indicated in my summary, what we are proposing this year in the budget, the Governor is proposing in the budget is what we call a teenage disincentive which says that if you are under the age of 18 and you are on AFDC, that you cannot go off on your own and get your own apartment, that you must stay with your parents, and that if you say that you have been abused by your parents, that we would go in exactly like we do for other child welfare programs, determine whether or not you are in an abusive situation. And if you are, we would then remove you from the home the way we do other children and we would put you in supervised setting.

The hope is we would put you in a family setting with another family. And if not, we would put you in a group home like we do other children now. We would not remove the child from you we would keep the child with you because we don't believe in splitting up families.

But it is our belief, and the Governor is very focused on this, it is our belief that young women under 18 are themselves still children and that they need to be supervised and helped to finish school and do all the kinds of things for them to grow up and become responsible citizens and financially able to take care of their children.

But at the same time, their young children are vulnerable so we don't want them at home in unsupervised settings. I think one has to look at—just imagine a 17 year old, and most of you look like you have teenagers and you know how our teenagers in the United States probably think. I used to say—I have children who are now 29 and 25—that I wouldn't let my 16-year-old daughter take care of the dog. So why would we let a 16 year old be in her own apartment by herself taking care of an infant? I think that doesn't speak well for us as a Nation.

I think the other thing is when we put a teenager in her own apartment, she becomes vulnerable to all the prey that is out there. And if you look at teenage birth information, especially in California, you will see that most of our teenagers do not get pregnant by teenage men.

So I suspect that we need to pay a lot of attention to what we think about young women, how vulnerable we want to make them. And I really do believe when we allow them to have their own apartments, get a cash grant, that we as the government are involved in government-sponsored child abuse.

Mr. BUNNING. Thank you.

I would like to address my remarks to Mr. Moy. If anyone was listening to your story, it is the story of the American dream. I mean, we must restore that in order to make sure that your children and your children's children are able to duplicate the same story that you have.

Mr. MOY. Thank you, Congressman.

Mr. BUNNING. What in your opinion is the most important portion of the Contract that would allow this to happen for you and for your children?

Mr. MOY. Well, I think that the most important part of the Contract With America is the taxing issues and problems that we face, capital gains as I mentioned, the estate tax. I think that we as a country have to help people and not punish people for making money.

I think that that is the most important part of the Contract. And I think we have to address those issues so that as my American dream is the Plum Garden, I can be comfortable and secure in handing that over to my children if they so want it and I think it is as important for Mr. Kettler here and all small businesspeople across the country.

Mr. BUNNING. Thank you.

Mr. Gibbons, you may inquire.

Mr. GIBBONS. Yes. First, I want to say to our witnesses from California, we are concerned about the damage you are having in your State right now. We wish you well in coping with it. And I bring that up because if we go along the path that we apparently are following right now, a couple of years from now we probably aren't going to be able to help you with those kind of natural disasters anymore because there just will not be the money available.

Now, Ms. Anderson, I know you are an expert in welfare and I assume you know a lot about how it is financed. What would be the impact upon California if in all the welfare reform that we do, and apparently this is what we plan to do, we do not keep the fact that a young dependent child is entitled to these benefits, in other words, there is no longer an entitlement to these young dependent children? What impact is that going to have upon the financing of welfare in California?

Ms. ANDERSON. Well, sir, I think it depends on how you structure whatever it is you are going to structure, but I suspect that if we don't have an entitlement, that we will rechange how we think in this country about what our individual responsibilities are and how we will go about that.

I also believe that many people on AFDC right now won't be there, that without an entitlement, they will do other things. I believe one of the things they will do is do family formation.

I believe that if we restructure AFDC or whatever we do in the right direction, that fathers will become far more attractive to mothers in ways that we haven't seen in the past 30 years. I believe that poor men will have much more worth when the mother gets pregnant than he does now. I believe that families would rally around each other in the ways that we have done for hundreds of years when crises happen. I believe Americans would probably even save more for rainy days the way we did when some of us were younger.

So I believe that if we structure this in the right way, that change always requires some dislocation, but I believe that change is not something we ought to be afraid of. And given however it may look, that I don't think it will be as bad as most of us think it is because I believe the belief right now is that the system we have in place is without harm and that is not the case.

Mr. GIBBONS. Well, I certainly hope that you are correct in all those changes in human behavior. That is something, of course, that only time will tell. But if the balanced budget amendment goes through, and it is probably going to go through, and if the Contract is adopted, and it is probably going to be adopted, there will be a 30-percent cut in Federal spending that has to take place each and every year, which means that probably the Congress will say, well, we are tired of paying these entitlements to the State of California for their poor.

Can the State of California pick up all that burden?

Ms. ANDERSON. Well, you know, I have watched my Governor for the past 4 years tighten our belt and manage and establish priorities. And if you give us the money back in our paychecks and quit taking it out of our paychecks, I think we would be more than happy to let this balanced budget go.

When I see what Governor Pete Wilson has done is that California has been in a recession and he has managed, he has set priorities, he has managed the government the way most families manage their own finances, and I think that we are ready for that kind of a change.

Mr. GIBBONS. Well, I notice that that same Governor has asked for Federal aid for more than half of the California counties as of today and I am not sure that we are going to have the money for those kind of disasters that seem to hit California more than they do other areas in the future. I hope you are right about that.

Mr. Moy, let me ask you a question. Do you have health insurance?

Mr. MOY. Yes, sir, I do.

Mr. GIBBONS. You personally? How about those 32 employees in your restaurant, do you have health insurance for them?

Mr. MOY. Yes, definitely. And what I have done is that I first initiated a policy where they began to work for me and they received a wage and then I gave them incentive to stay with me by offering them benefits.

Mr. GIBBONS. Do your competitors in the restaurant industry supply health insurance for their employees?

Mr. MOY. I believe a lot of them do. A lot of them do and I think they have used this as an incentive to keep staff strong.

Mr. GIBBONS. All right. Thank you.

Mr. BUNNING. Mr. Camp will inquire.

Mr. CAMP. Thank you, Mr. Chairman.

Ms. Anderson, you mentioned in your written testimony and I think in your verbal remarks the current system seems to be void of trust, that no one seems to trust the States. And I think in the debate that we have over the next few weeks and months, how do we satisfy the people who don't trust the States?

And as we look toward block granting programs, possibly, and giving more responsibility and authority to the States I think we are going to hear that from opponents. If you have any thoughts on that I would like to hear them.

Ms. ANDERSON. I think the Federal Government has to do what the Governor has done in his proposal with the counties in California and that is to say let's look to outcomes, let's together decide what are the outcomes that we want to happen in these programs and hold us accountable for those.

And I don't know why—I have some ideas about why there is such a lack of trust, but I think we need to get past yesterday and not build a future on how the States did things 30 years ago or 100 years ago. I think we can sit down and agree on what these programs need to have as outcomes and then give us the block grant and then hold us accountable for that.

Mr. CAMP. Thank you.

My next question really goes to Mr. Moy and to Mr. Kettler. In the Contract With America, the small business—we would increase small business expensing to $25,000 annually. It is currently $17,500. Would that be helpful in the restaurant business, and Mr. Kettler, would that be helpful to farmers?

Why don't you start first, Mr. Moy?

Mr. MOY. Definitely. I bought my first walk-in for $600. I just replaced my walk-in last year for $5,000. So I think there is definitely an inequity there due to inflation and just the cost of goods. I think we should even raise it a little bit more.

Mr. CAMP. Thank you.

Mr. KETTLER. I couldn't agree more with Mr. Moy. I think any time you allow us the latitude to expand, we will take that latitude and we will expand. We will get more efficient. We will make better use of our own money. As Ms. Anderson said, if you give me the means to manage my own money, I will manage it.

Mr. CAMP. I want to thank all the witnesses for their testimony and, Dale, I appreciate you coming all the way from Michigan.

Thank you very much, Mr. Chairman. I yield back the balance of my time.

Mr. BUNNING. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Ms. Anderson, I heard you comment that you did support the elimination of cash payments for teenagers or children having children, but under the Contract, is it not true that only the cash payment would be eliminated, the food stamps and the health care would remain?

Are you familiar with that portion of those provisions?

Ms. ANDERSON. Well, I think that we are—if the child remains at home and—I mean, the teenager remains at home with her parents, then I think it depends on how you want to structure that and I think States ought to be allowed to structure that the way they want to.

If the teenager wants to stay with their own family, then I think giving them a cash amount and setting them up in their own apartment is detrimental to them and to their child long term and we really ought to be looking at the child welfare system for them, which is not a place that we give them food stamps. It is not a place that we do anything but we provide for them through payments to the foster parents or payments to the group home. And I think that we should think long and hard before we establish a young person in an adult role before they are ready.

Mr. COLLINS. Yes. Well, the purpose of that is to also put in place parental responsibility by having the teenager live at home. This puts the responsibility on the teenager's parents which I think could be very helpful in rendering solutions to children having children if other parents knew they would have that responsibility placed back on them.

Mr. Moy, is your restaurant a family restaurant?

Mr. MOY. Yes, sir.

Mr. COLLINS. With the $500 tax credit for each dependent child at home, then possibly some of those $500 credits would be spent in your family restaurant in your area; is that right?

Mr. MOY. I hope so.

Mr. COLLINS. I do, too.

Ms. Klapperich, I can appreciate your situation. As a young person from the age of about 12 to 17, I, my mother and dad, we took seniors into our home, and that was back in the early fifties, for the purpose of taking care of them before the nursing home ever became popular. And I have seen a lot of elderly people that were in the condition that I see your mother was in and I can appreciate what you went through.

Mr. Kettler, you are a small businessman. You say you are a farmer. A farmer is a small businessman; is that not true?

Mr. KETTLER. That is very true. I am a small fish in a big pond. I can appreciate the things Mr. Moy goes through. I have a small farm in a huge industry called agriculture.

Mr. COLLINS. Maybe you can produce some of those vegetables that Mr. Moy will sell to some of those families that are going to get the $500 tax credit.

Mr. KETTLER. I am going to corner him in the hallway as soon as we leave.

Mr. COLLINS. We plan to reinstate the 25-percent health care deduction. It takes quite a bit of equipment to farm 500 acres of land; is that not true?

Mr. KETTLER. Yes, it is true. We have a huge outlay both in land and in equipment. The most visible, I think, people look at tractors and I always try to bring out the point that having a tractor that may cost between $50,000 and $100,000 is like going to a car dealer and just buying a motor, because a tractor doesn't do anything until you hook things behind it. So you know, there are—it is just a huge investment.

Mr. COLLINS. Annually, what type of investment do you make on equipment, do you have any idea? I know you probably don't buy equipment every year. Say you average it over a 10-year period. What would be the amount of equipment you would purchase in a 10-year period?

Mr. KETTLER. Right now, my tractors and combines are both getting up in age just because we try to maintain our equipment and hold on to it. I probably spend maybe $10,000 a year on maintenance for the 500 acres of farm.

Mr. COLLINS. Well, maintenance is a very important part of equipment, too. I appreciate each of you being here.

Thank you, Mr. Chairman.

Mr. BUNNING. Mrs. Kennelly.

Mrs. KENNELLY. Yes. First, let me thank Ms. Klapperich for coming. I know that you deal with what so many people in America deal with, trying to have children on the one hand and older parents on the other and tuition costs for college go up and parents' health care costs more.

And I thank you for taking the trip and coming and pushing that because long-term care, as we all know, is very expensive and unless we keep talking about it and getting it into the mix, we are not going to do anything about it.

Mrs. Johnson and I have for years looked at long-term care where you get an ability to at least buy insurance to protect yourself, but we keep having to move it and trying to have people get it discussed as we talk about these things that are going to happen very quickly.

So I thank you very much for coming to be with us.

Ms. Anderson, can I just take this a little further with you because we are all wrestling with the situation about what do we do when someone does get pregnant out of wedlock, has a child, and is young. Of course, the best thing is to have them stay at home within the family situation, but as we know, often there isn't an intact family for her to stay in or for some reason she just can't.

And you are suggesting as an alternative a group home where the mother and child would be together with a support system?

Ms. ANDERSON. I am suggesting that, first, we look for a family, a family foster home for her and her child. I think a family setting is the best setting. Children learn how to be a family by being in a family. The best learning tool for a family is being within one.

If that is not appropriate and for every young woman or young girl that will not be appropriate and then we would put them in a group setting with other young girls who have children where they would be supervised, where they could finish their high school education, where they can learn the kind of parenting skills they need, where we can teach them the kind of financing skills they need, where we can teach them cooking and all those other kinds of home maintenance skills they are going to need as they get out on their own. So I am not thinking about and the Governor clearly is not thinking about putting these young girls out on their own with their infants.

Mrs. KENNELLY. I do know your Governor has supported staying at home, staying in school.

Ms. ANDERSON. Yes.

Mrs. KENNELLY. That is in a family setting.

Ms. ANDERSON. Yes.

Mrs. KENNELLY. Of course, you have eliminated, as so many others have, the idea of separation of mother and child.

Ms. ANDERSON. Yes.

Mrs. KENNELLY. You are looking at foster care to support the foster care we have now.

Ms. ANDERSON. Yes. Actually, we are seriously saying that for us when a teen mom cannot live at home, it is not an income transfer issue, it is actually a child protection issue and that we need to start treating it as if it was a child protection issue.

And what we have done in the past is treat it as an income transfer issue, so we send money and we don't pay attention to what is going on. Our view is we need to stop doing and we need to start treating her as if it were a child welfare issue and treating her like all other children who are being abused and neglected by their parents.

Mrs. KENNELLY. And 18, would that be the cutoff?

Ms. ANDERSON. Yes. That is an adult in our society now, but if she hasn't finished high school, we have a Cal-Learn program that I think goes up to the age of 19 which tries to get her to finish high school.

One of the things that we look at is that teen moms who don't finish high school have a high chance of creating that situation all over again. So high school education is clearly important to us and we have the Cal-Learn program in place that supports high school completion, it supports good, decent grades, and it has a sanction in for children who don't produce good grades. And it is for pregnant and parenting teens.

Mrs. KENNELLY. Thank you for these positive suggestions. Thank you very much.

Mr. BUNNING. Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

I thank the panel for coming today. I didn't get a chance to hear your testimony, but I have read your remarks and I am reminded why I came to Washington and it is because of you that we are out there fighting to make this a better place to live.

My family is in the family farm business in Nebraska and my entire family farms, and I can't tell you how much I heartily agree with each of your points in your written testimony here. You are not rich when you have a $600,000 farm when you are talking about equipment and land.

And for that to be the minimum as far as estate tax exemption and we are going to raise that to a paltry $750,000, that is hardly an increase when you are talking about the family farm. And you can count on this Congressman to do everything he can to get it to a slightly higher number where it will help more farmers.

Mr. KETTLER. Thank you very much.

Mr. CHRISTENSEN. I hope that we can do that.

Mr. Moy, I would like to ask you a question on the minimum wage because there is some talk about raising the minimum wage.

I was wondering what your thoughts are on that and if raising the minimum wage was sending exactly the wrong signal to small business owners because maybe we should have a subminimum wage for these high schoolers that get out and go to work rather than raising the minimum wage.

Won't a minimum wage increase do almost just exactly the opposite of what we should do?

Mr. MOY. I agree with you, Congressman. My feeling is that if the minimum wage was increased, it would be detrimental to our industry especially because we start out people right away, we accept people as they come in without any type of formal education and I feel that it would hurt the small business operator like myself if we are faced with the increased cost of an increase in minimum wage. So I think there is a potential for indexing, like you say, but I think that as an entry level job supplier to this country, the increase in minimum wage would really hurt us.

Mr. CHRISTENSEN. Yesterday we heard testimony from one of the witnesses that you have a 93-percent chance of staying off the poverty rolls if three simple things happen: One, you graduate from high school; two, you have a job; and three, you don't have children out of wedlock. Three very simple measures, but three that seem to be very hard for this society to achieve. Basically 7 percent of the people—7-percent chance of hitting the welfare rolls if those things don't happen.

And Ms. Anderson, in California, I was wondering what is being done to encourage more of our young people toward not having illegitimate or out-of-wedlock births. What is being done as far as your State is concerned?

Ms. ANDERSON. We have got two things happening. One is we have the Cal-Learn program that emphasizes pregnant and parenting teens in schools. It says we want you to go to school and be successful in school and if you are successful, we give an increase in your grant. If you are not successful, we will give you a decrease in your grant.

We also have case management around that because we think when in many cases when a young person has a child out of wedlock, there are other issues that are going on in that family and we want to try to get in and deal with those other issues.

The other thing that we have in that proposal is to say if you get pregnant and you are a minor and you want to leave home, we are not going to let you do that—at least we are not going to support that with a paycheck. And if you say that you are being abused at home, that we will then move you to a foster family setting and if that is not appropriate, to a group home.

So we are doing everything, at least with the AFDC caseload, that we can to stress high school education, but we have also done things in the larger AFDC program. We have said that we believe that a couple of things need to happen, that we believe in work and that AFDC should be—work should be more than AFDC.

So we have changed the structure of our program around. We have cut the AFDC grant, but we have allowed people on AFDC to make back every dollar that we have cut through work. We have also said that one of the things that has to happen on AFDC they have got to be able to save. I call it the American dream account. You can't—every time you make a dollar, put a little bit in the bank, we can't take that away from you.

One thing that, at least everything I have learned about this country we do is we future. The only way you can future is to be able to put something aside. So we allow people to have a savings account, keep up to $2,000 in one savings account which we call a rainy day account. And we have what we call the American dream account and with that savings account you can save for a home, you can save for your own business, and you can save for your college education for your kids.

It is important that we believe that we give a new message in AFDC and that message is that we think that you are a rational, capable human being, capable of getting out here and doing everything else everybody else is doing, that we are not going to treat you differently, that we expect if you have a child that you and the father will jointly be responsible for that.

And every now and then, a crisis is going to occur that you are going to be in bad times. We expect to be there in crises but we do not expect this to be a lifetime place for you to be.

And so with that message getting out there, hopefully kids will say, gee, this isn't what I want to do, this is not what I want to do with my life.

Mr. CHRISTENSEN. Thank you.

Mr. BUNNING. The gentleman's time has expired.

Mr. Shaw will inquire.

Mr. SHAW. Thank you, Mr. Chairman.

Ms. Anderson, you are associated with Riverside County?

Ms. ANDERSON. Riverside County is one of the counties in California, yes.

Mr. SHAW. It is one of the programs that we often hear about as being a very successful program. How do they go about motivating these youngsters where these other programs are failing?

Ms. ANDERSON. If you ever met Larry Townsend, you would know this is a man—I have known a lot of welfare directors—who actually believes that his clients are capable and can do something. I mean, he talks about work every time I see him. He sends me CDs that his people make about work. He goes out and looks for jobs. His employees go out and look for jobs. His clients go out and look for jobs. He really stresses work. I think that makes all the difference for him and I believe if we could remove some of the barriers that we have, he would even have more people working. And I think it is an attitude difference and he has a serious attitude difference.

Mr. SHAW. I have met him and I agree with you. Would you expand on what some of these barriers might be? Would you say one of the barriers is the current welfare program?

Ms. ANDERSON. One of the barriers is the current welfare program, yes. A couple of the barriers is the paperwork you ask us to do. If a worker, an income maintenance worker has a person on their case who has a job, it is a huge workload. So if I am a worker and you come up to me and you tell me I got a job, I am going to be real upset with you because you have just made my work really more difficult. So we got a lot of incentives in here for the recipient not to work because you are going to make my job harder if you work. Then we have a lot of——

Mr. SHAW. Is that Federal redtape?

Ms. ANDERSON. A lot of it is Federal, some of it is State, based on the Federal regulations, that we need to undo the way we have structured the program, that we really talk about education first and a whole lot of other things we want you to do.

I think we have to believe that work is one of the best educational tools there is out there and that when people go to work and they learn about work, sometimes they are not going to be successful, but over time they will be successful and that we need to move away from more of this in the classroom stuff and more into the work force stuff.

Mr. SHAW. Did you hear Governor Weld this morning?

Ms. ANDERSON. Yes, I did.

Mr. SHAW. He spoke to that question.

Ms. ANDERSON. Yes, he did.

Mr. SHAW. And he said he was a great believer that the best place to learn a skill is to work.

Ms. ANDERSON. That is right. I agree with him totally.

Mr. SHAW. You agree with that?

Ms. ANDERSON. I agree with that totally.

Mr. SHAW. Is that partly because of the attitude change that is necessary to instill in these people?

Ms. ANDERSON. Yes. I think people have to know that you expect something out of them. I think that the human animal is like any other one, we live up or down to your expectations. If we have no expectations of people, they live right up to those no expectations. If we have expectations of them, they live up to those.

We have a system that has no expectations. It doesn't expect anything out of people and it gets nothing out of them. We need to change that expectation system around and people live up to that.

We also need to—I always say we treat these people like they are not capable. They can bring any excuse to us and then we let them off the hook. We need to stop that. We need to demand things out of them, hold them accountable, and they will come around.

And we don't do that. They bring us an excuse and we go with it and we just let them get off the hook all the time. And I think we need to change that way of dealing with them.

I think one of the problems that we have is that if the system went away, what would happen to us, the bureaucrats. I think we are scared of our own unemployment, not their employment. And I think we need to be very aware of that.

Mr. SHAW. Well, I think that many of the bureaucrats are going to have to adopt the attitude that you have that they will lose their jobs. Thank you.

Thank you, Mr. Bunning.

Mr. BUNNING. Ms. Dunn.

Ms. DUNN. Thank you, Mr. Chairman.

And I apologize to the witnesses but I was detained in my office and couldn't be here to hear your statements and the questions. So please stop me if I am asking something that is repetitive.

My concern right now is where the responsibility lies for all the parts of the welfare reform program that we are trying to design here in the committee. And I have heard the Governors state that they would like us and read that they would like us to send block grants to their States with no strings attached.

If that were the case, I don't understand why the money would need to come through the Federal Government where it goes through a buffer of lots of bureaucrats and takes away a huge amount of money that could be effective in the States.

And so I would like to ask you, Ms. Anderson, do you have a sense, if you were designing the program that we are putting together from all the alternatives, of what responsibilities you would like to see left with the Federal Government versus what you would like to see the States assume as we turn back more responsibility to the States?

Ms. ANDERSON. Well, when I think about that, I sort of would like probably a lot less of the reporting that we have to do. I would like to not to have a waiver process to do something. I would like to figure out what are your needs in terms of outcomes, what are you looking for, and for us jointly to determine what the outcomes of this program ought to be and figure out how we can get there.

I don't know if we—if you should look at just AFDC when you look at this program. I think you ought to look at a larger view. I think you need to bring the Wagner-Piesner Act, the Carl Perkins Act, the disability Federal regulations, the alcohol and other drug regulations into place, because when you look at the population on AFDC, I think you need to look at that whole variety of things and not narrowly focus on just AFDC because I think there are a lot of things that impact this program that I wish you would put on the table.

And I think that I have heard and I know that Governor Wilson clearly doesn't mind being held accountable, giving us taxpayer funds. He is not suggesting you put the money on a stump and run. He is suggesting you give us a lot more flexibility, give us reasonable outcome measures and we would be held accountable to those.

Ms. DUNN. Good. And I am sure you have discussed, since you are from California, the issue of the legal aliens, but could you state for my information whether you believe that that should—that that should remain a guideline that the Federal Government requires that there be no funding for welfare for legal aliens?

Ms. ANDERSON. Governor Wilson is very clear on legal aliens, that he believes that they enhance the country. He supports them. But when you bring them into the country, that you carry out, the Feds keep up their responsibility. If you say that you are going to be there for 5 years with them in terms of funding, to do that when you bring refugees in. We have a 36-month, right now, responsibility, which the Feds haven't lived up to. We want you to live up to that so in the area of whatever you do on the legal immigration side, we hope that you just keep your word and your promise with that and if you bring people in, that you support them the way you said and you don't walk away from that.

Ms. DUNN. If we did not retain the strings that are attached to States that say you may give no funding to legal aliens, would the State of California fund welfare for legal aliens?

Ms. ANDERSON. If you say that we would not give funds to legal aliens, I think the Governor has been very clear that he has not ever suggested that we would not provide services to legal aliens. It has always been the illegal aliens that has been at issue.

Ms. DUNN. Thanks.

Mr. BUNNING. Ms. Klapperich, I would like to ask just a couple of questions because H.R. 8, which is the Senior Citizens' Equity Act, addresses some of the problems that you might have had.

Has Medicaid or Medicare paid for any of your mother's long-term health care problems?

Ms. KLAPPERICH. No. They pay for some of her medications once her other insurance has picked up some of the costs.

Mr. BUNNING. Would you like for your employer to offer you the option to purchase long-term health care insurance?

Ms. KLAPPERICH. Yes.

Mr. BUNNING. That is part of H.R. 8.

Ms. KLAPPERICH. Yes.

Mr. BUNNING. The Contract With America provides for a similar treatment for long-term care health insurance such as that for health and accident insurance. Long-term health care premiums would be excluded from the employee income and would be deductible as a business expense for the employer.

What effect would this proposal have on your decision to purchase long-term health care insurance for yourself?

Ms. KLAPPERICH. Having had the experience that I have had with my mother, there is no question that I would purchase long-term care insurance whether there are tax incentives to do that or not.

My husband and I are very committed to long-term care insurance and try to let everybody we know hear about it and know what our experience has been. If there were tax incentives to do it, of course, we would be thrilled with that, but it is something that we are going to get anyway.

Mr. BUNNING. The Chairman would like to thank you for your testimony. When we hear from the real people, as we call the people that come like you to our committee and testify, we really appreciate your effort. Some of you have come from long distances. Thank you for being here and we are looking forward to seeing you again.

Thanks.

If the next panel would please be seated. John Motley, NFIB; Carol Ball from the board of directors of the U.S. Chamber of Commerce; Paul Huard, National Association of Manufacturers; and Sheldon Friedman, the AFL–CIO.

Since we have one of our leadership people with us, the chairman of our conference, he has a special introduction that he would like to make.

Mr. Boehner.

Mr. BOEHNER. Mr. Chairman, I appreciate the opportunity to introduce to the committee a constituent, more importantly a close friend of mine from my district. I owe a great deal to Carol Ball, who is with us today representing the U.S. Chamber.

When I decided to run for Congress, no one knew me in the northern part of my district. Carol was one of the first people aboard my campaign. She and I had worked closely in Columbus on business issues that came before the State legislature in Ohio and became very good friends. And I think I can say safely today that if it weren't for Carol's help, I wouldn't be in the Congress today. Probably some of my colleagues wish that was the case. You don't have to speak up now.

But Carol founded and runs Ball Publishing Co. in Darke County, Ohio, and they publish a paper called the Early Bird. It is really the first countywide newspaper in Darke County. She served as a national board member for the U.S. Chamber of Commerce. In addition, she serves on her local chamber and has been instrumental in helping build it into a successful organization.

Carol understands the meaning of success because she has had to do it on her own. She fully appreciates I think the hardships and difficulties experienced by many small businesspeople because of the oppressive tax policies of the Federal Government. I often turn to Carol for advice on matters that are affecting small businesses. I believe that she can provide valuable wisdom and insight for this committee and for this Congress.

And Carol, I would like to welcome you to the Ways and Mean Committee on behalf of your Member of Congress.

Welcome.

Ms. BALL. Thank you.

Mr. BUNNING. Since Mr. Boehner has done such a great job in introducing you, we will let you start us off, Ms. Ball.

STATEMENT OF CAROL L. BALL, REGIONAL VICE CHAIRMAN AND MEMBER OF THE BOARD OF DIRECTORS, U.S. CHAMBER OF COMMERCE, AND PUBLISHER AND CHIEF EXECUTIVE OFFICER, BALL PUBLISHING CO., ARCANUM, OHIO

Ms. BALL. Thank you, Congressman Bunning, and thank you so much, Congressman Boehner, for that very kind and generous introduction.

I am here today in my role as regional vice chairman and member of the board of directors of the U.S. Chamber of Commerce and even though I may be summarizing some of the notes I have in front of me, I do ask that my statement be placed in the record.

Mr. BUNNING. Without objection.

Ms. BALL. And the chamber does greatly appreciate having this opportunity to testify before the House Ways and Means Committee on the House Republican Contract With America.

Since its inception, the chamber has been dedicated to one basic goal: To advance human progress through an economic, political and social system based upon individual freedom and incentive, initiative, opportunity, and responsibility. We believe achievement of this goal requires the combined efforts of both the public and the private sectors and clearly the Contract With America shares this vision by placing our fiscal house in order, reducing the intrusiveness of Federal regulations, providing for the safety of our citizens from both internal lawlessness and external forces, creating incentives for individuals to get and keep jobs, and reducing the tax burden on individuals and businesses. The tenets of the Contract go to the heart of the America fabric.

We commend Speaker Gingrich and the chairman of the committee and the other members of the committee for addressing these issues so early in the new Congress. The Contract covers numerous proposals grouped into 10 areas. A number of these reflect longstanding chamber policies and priorities.

Last October, the chamber surveyed our entire membership on these issues. Unfunded mandates and the balanced budget amendment were rated the two most important issues with capital gains tax cuts, welfare reform, and regulatory relief close behind. And more recently the chamber surveyed the 800,000 readers of its magazine, Nation's Business, on the 10 areas included in the Contract.

Here again, the support for the balanced budget amendment, reductions in individual tax rates, capital gains tax cuts, welfare reform, and regulatory relief was overwhelming.

The chamber is committed to working with you on these provisions of the Contract and on other critical pieces of legislation that will be considered during the balance of the year to make them a reality. And let me turn to those provisions of the Contract that fall directly under the purview of this committee.

Tax policy has a large role in our economic environment and good tax policy can stimulate investment, foster new business creation, spur job growth, encourage individuals to work and save more, but however, bad tax policy can retard capital formation, hinder entrepreneurship, reduce job growth, and discourage the work force. The chamber has long championed the need to reduce the tax on capital gains. Cutting the capital gains rate and indexing capital investments for inflation would spur investment activity, create jobs, and expand the economy, benefiting all income classes.

In 1993, 55 percent of the individual income tax returns reporting capital gains were filed by taxpayers with adjusted gross incomes under $50,000 and 73 percent of the returns with adjusted gross incomes under $75,000. An adoption of a neutral cost recovery system also has been long advocated by the chamber, allowing businesses to fully recover the economic costs of their depreciable assets. And we also support increasing the amount of equipment purchases the business can immediately expense from $17,500 to $25,000 per year. We believe this provision would encourage businesses to invest more. And the current $600,000 estate and gift tax exemption has never been indexed for inflation nor increased since it was fully phased in in 1987. We need to look at this.

In addition to the aforementioned provisions, there are a number of proposals that could lessen the tax burden of families, married couples, and the elderly. The chamber believes that reducing the tax burden on these sectors and returning disposable income to those who earned it will enhance consumption, boost economic activity, and encourage added participation in the work force.

These are some of the problems we face. We are here to help you. We look forward to working with you and we thank you for having us here today.

[The prepared statement follows:]

TESTIMONY
on
THE CONTRACT WITH AMERICA
before the
HOUSE COMMITTEE ON WAYS AND MEANS
for the U.S. Chamber of Commerce

by
Carol L. Ball
Regional Vice Chairman
January 12, 1995

Mr. Chairman and members of the Committee: good afternoon. I am Carol L. Ball, Publisher and Chief Executive Officer of Ball Publishing Company located in Arcanum, Ohio. I am here today in my role as Regional Vice Chairman and member of the Board of Directors of the U.S. Chamber of Commerce.

The Chamber speaks for large and small businesses from every line of commerce and industry, from the smallest communities to the largest cities of America. We represent 215,000 businesses, 3,000 state and local chambers of commerce, 1,200 trade and professional associations, and 72 American chambers of commerce in 65 foreign countries.

The Chamber greatly appreciates this opportunity to testify before the House Ways and Means Committee at the outset of this historical transition to address the House Republican *Contract With America*.

Since its inception near the turn of the last century, the Chamber has been dedicated to one basic goal. In fact, this goal is expressed in our mission statement: "To advance human progress through an economic, political and social system based upon individual freedom, incentive, initiative, opportunity and responsibility." The Chamber believes that achievement of this goal requires the combined effort of both the public and private sectors. The government's role is to create an environment that is safe from both outside aggression and inside strife, protects individual freedom and encourages prosperity. Within such an environment, the private sector can do its part by creating a vibrant economy, a rising standard of living and a business sector that is competitive in the global economy of today and tomorrow.

Clearly, the *Contract with America* shares this vision. By placing our fiscal house in order, reducing the intrusiveness of federal regulations, providing for the safety of our citizens both from internal lawlessness and external forces, creating incentives for individuals to get and keep jobs, and reducing the tax burden of individuals and businesses, the tenets of the *Contract* go the heart of the American fabric. We commend Speaker Gingrich and you, Mr. Chairman, on the *Contract* and for beginning the process of ridding the business community of government impediment that too often stifles growth.

A number of these provisions reflect long-standing Chamber policies and priorities. Last October, the Chamber surveyed its entire membership on these issues. Unfunded mandates and the balanced budget amendment were rated the two most important issues for American business. Capital gains tax cuts, welfare reform and regulatory relief were close behind. More recently, the Chamber surveyed the 800,000 readers of its magazine, *Nation's Business*, on the ten items included in the *Contract*. Here again, the support for the balanced budget amendment, reductions in individual tax rates, capital gains tax cuts, welfare reform and regulatory relief was overwhelming. The Chamber is committed to working with you on the provisions of the *Contract* and other critical pieces of legislation that will be considered during the balance of the year to make them a reality.

Let me turn now to those provisions of the *Contract* that fall under the purview of this Committee. Tax policy plays a disproportionately large role in our economic environment. Good tax policy can stimulate investment, foster new business creation, spur job growth and encourage individuals to work more and save more. However, bad tax policy can retard capital formation, hinder entrepreneurship, reduce job growth and discourage the work force.

For example, implementation of a luxury tax several years ago not only failed to produce anticipated revenues, but devastated the entire pleasure boat industry. Elimination of the capital gains deduction in 1986 resulted in fewer capital transactions, lower investment and less overall tax revenue. The first of these mistakes has been corrected; the latter awaits your efforts.

The Chamber has long championed the need to reduce the tax on capital gains. Cutting the capital gains rate and indexing capital investments for inflation would spur investment activity, create jobs and expand the economy – benefiting all income classes. In 1993, 55 percent of the individual income tax returns reporting capital gains were filed by taxpayers with adjusted gross income under $50,000, and 73 percent of the returns were with adjusted gross income under $75,000. Furthermore, capital-gains rate reductions have historically proven to be a revenue-raiser for the federal government.

Adoption of a neutral cost recovery system also has long been advocated by the Chamber. Because inflation erodes the value of capital expenditures, companies never fully recover the true economic value of their investments through depreciation. Neutral cost recovery would permit businesses to fully recover economic costs by allowing upward adjustments to the historical cost bases of their depreciable assets. These adjustments would stimulate investment, enhance productivity growth and increase economic activity.

The Chamber also supports increasing the amount of equipment purchases that businesses can immediately expense from $17,500 to $25,000 per year. We believe this provision would encourage businesses to invest more resources into productivity-enhancing equipment because it would reduce their up-front capital costs. Accelerating the timeframe that businesses can depreciate their equipment would give owners an incentive to purchase additional equipment and expand their businesses sooner rather than later. Along with the *Contract's* capital gain reform and neutral cost recovery provisions, increased Section 179 expensing would help stimulate much needed capital investment in this country.

The current $600,000 estate and gift tax exemption has neither been indexed for inflation nor increased since it was fully phased-in in 1987. The current system depletes the estates of those who have saved and can force a successful family business to liquidate. The relatively low threshold for imposing estate and gift taxes motivates people to make financial decisions for gift and estate tax reasons rather than for investment and business objectives, needlessly wasting resources that could be put to productive use. Reducing the need for expenditures of time, energy and money for non-productive pursuits would permit business owners to devote their efforts and capital to the country's economic growth.

One of the biggest problems facing the American economy today is the decline in the rate of savings. Savings is the yarn used to weave the American economic fabric. Insufficient savings means inadequate capital formation, faltering productivity growth, flagging real wage growth and a lower standard of living. The Tax Reform Act of 1986 reduced the incentives for savings and capital formation by curtailing individual retirement accounts for many individuals. The Chamber believes that reintroduction of a tax-exempt savings vehicle would provide a significant help in correcting this deficiency.

In addition to the aforementioned provisions, there are a number of proposals that would lessen the tax burden of families, married couples and the elderly. The Chamber believes that reducing the tax burden on these sectors, and returning disposable income to those who earned it, will enhance consumption, boost economic activity and encourage added participation in the work force -- all of which help to create a more vibrant economy.

Too often in the past, our government has compounded economic and social problems by imposing needless regulation, increasing our tax burden, removing incentives to work and thwarting the decisions of the marketplace. Nowhere is this more obvious than in the fiscal mismanagement of our government finances. More than 25 years of excessive spending have saddled us with large annual deficits and a growing level of debt. The Balanced Budget Amendment would go a long way toward restoring fiscal responsibility and enhancing credibility. The Chamber urges you to pass this amendment and send it to the states for ratification.

You, the members of the Ways and Means Committee together with the balance of the 104th Congress, have the opportunity to change our destiny. The provisions outlined in the *Contract with America* provide a clear and bold first step. You have already achieved a remarkable, inspiring and historical beginning and we at the Chamber look forward to actively working with you to complete the process.

Thank you. I would be happy to answer any questions.

Mr. BUNNING. Thank you, Ms. Ball.
Mr. Motley.

STATEMENT OF JOHN J. MOTLEY III, VICE PRESIDENT, FEDERAL GOVERNMENTAL RELATIONS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. MOTLEY. Thank you, Mr. Chairman.

First of all, let me say it is a pleasure to follow my good friend, Carol Ball, here who has been an active member of not only the chamber but NFIB for years and she gives a great deal of herself, as you know, Congressman Boehner.

Thank you for the opportunity of coming here today and testifying on behalf of the NFIB and our 600,000 members across the country, specifically on those elements of the Contract which come before the jurisdiction of the Ways and Means Committee. I have a lengthy statement which I will submit for the record and summarize for the committee.

First of all, let me share with you five criteria by which we believe most small businesspeople judge any actions in the tax area. First of all, keep it simple. Complexity is the bane of small business owners. Many of them even to this day do not hire accountants to do their books; they do them themselves just like they do most other things in their businesses themselves.

Second, cash flow is the key. Having money up front rather than applying for deductions and credits later on is critical to the life or death particularly of newer businesses.

Third, capital formation is needed for growth. Once you survive, then you have to worry about the next phase, how you are going to grow the business and how you are going to get the capital to do it.

Fourth, tax policy needs to promote economic growth for the country as a whole because small business both rises or falls with the economy of the rest of the country.

And last, it needs to be fiscally responsible. The day has passed when we can do things in this country where we are not willing to pay for them up front.

How do small business owners feel about the Contract? Generally they support the Contract With America because it addresses their deep concerns about the role of government in the day-to-day operations of their businesses. Specifically, they feel more strongly about some elements than others, such as expensing, estate taxes, and capital gains because these elements are more small business friendly than some of the other elements in the Contract, but as a whole, they believe that it is something that needs to be done. It is one of the reasons that they went to the polls in November in record numbers. Let me comment briefly, if I can, on several of those aspects of the Contract that we believe small business owners support very strongly.

First of all, the expensing of capital assets is a vastly preferred method of depreciation within the small business community. It is simple. It helps firms' cash flow and it encourages investment in economic growth across the board.

Second, clarifying the home office deduction, which needs to be clarified and also needs to be broadened from the recent court decisions because it is very confusing to people who want to start small businesses in their homes. And in many cases, the home is the cradle of new small businesses in this country. I have a number of relatives who still run their businesses out of their homes, even though their businesses have grown beyond the point of just being day-to-day or every-other-week affairs. Also, as we move into the information age and into the technology age, I believe that home-based business is going to play a greater and greater role.

Therefore, we have to provide clarity. And what is in the Contract With America is a great step in this direction and we would strongly urge you to be very specific in the report language that goes along with the bill to the floor.

Third, easing the estate tax burden. Estate taxes destroy successful businesses that have been built over lifetimes and they drain them of resources that they can use for more productive purposes. The burden needs to be reduced, and if you have any other goals in the future, eliminated completely. There is no reason why we should destroy successful businesses in the country.

Fourth, cut and index capital gains because it will attract capital to small businesses and reward risk takers and we need them.

And fifth, reduce middle-class taxes. Most small business owners are part of the middle class. The average income of NFIB members is about $40,000 a year. And a cut in individual taxes in any shape or form provides cash flow for those businesses.

Let me very quickly suggest six other areas where NFIB believes you can expand on the Contract and also perfect it. First of all, and most important, to provide a 100-percent deduction for self-employed individuals for the purchase of their health insurance. The 25-percent deduction that they had before is gone and they are one of the largest single groups of people in this country without health insurance today. Twenty-two percent of them don't have it and by providing them equity with larger firms, you can encourage them to go out in the marketplace and purchase health insurance.

And second, let me also suggest that you closely take a look at exempting all closely held business, farm and ranch assets from estate taxes completely. By our estimation, the revenue loss is only $1.2 billion a year, and for that you can exempt it and ensure that no business is ever destroyed because of a tax collector and no jobs are lost because somebody has to pay estate taxes in this country.

On expensing, we think $100,000 is a better figure than the $25,000 that is the Contract. If you want to provide the equivalent of expensing, why not just provide expensing?

On capital gains, exempt investments in smaller businesses which need the money a great deal and do not have access to the public securities market to raise capital. Exempt those investments completely from capital gains.

Simplification is needed. Myriads of forms and accounting methods for the smallest firms are a big problem and you should think seriously about allowing the smallest firms to use simpler methods, even though they may not be as precise, until they grow to the point where they have to be very precise in identifying their income.

And last, the whole question of independent contractors is terribly, terribly confusing not only to independent contractors but to the people who employ them. It is a real problem and needs to be defined, and what we would suggest is a second safe harbor which has several simple tests in it which give these small business owners some degree of certainty.

I would like to conclude, Mr. Chairman, with just a word about rates and to remind the committee that most small businesses in the United States are unincorporated. More than 80 percent of the business tax returns that are filed in this county are filed as individuals—either proprietorships, partnerships, or subchapter S corporations. Fifty percent of NFIB members file that way.

And successful self-employed individuals have been hit tremendously since 1990 with tax increases, roughly a 60-percent increase since 1990 in taxes that the successful small business self-employed people pay.

Therefore, we would suggest that if you want to provide a significant tax reduction to small business owners in this country, provide them cash flow and capital formation, that you should seriously, at some point in time, take a look at reducing rates as proposed in the bill introduced by the Speaker and Mr. Armey just before the conclusion of the last Congress.

Thank you.

[The prepared statement follows:]

STATEMENT OF

JOHN J. MOTLEY III

VICE PRESIDENT
FEDERAL GOVERNMENTAL RELATIONS

NATIONAL FEDERATION OF INDEPENDENT BUSINESS (NFIB)

Subject: The Contract with America: A Small Business View

Before: House Committee on Ways and Means

Date: January 12, 1995

Thank you, Mr. Chairman. My name is John Motley, and I am Vice President for Federal Governmental Relations for the National Federation of Independent Business (NFIB). NFIB is the nation's largest small business advocacy organization, representing over 600,000 small business owners from all fifty states. The typical NFIB member has five employees and has $250,000 a year in gross annual sales. NFIB sets its public policy positions through regular polling of the membership.

Goals of the Contract with America

Mr. Chairman, I appreciate the opportunity to participate in this hearing examining the provisions of the Contract with America that fall within the Ways and Means Committee's jurisdiction. The process in which you are now engaged is historic -- it is the beginning of a debate that will hopefully lead to a substantial reduction in the tax, spending, and regulatory burden imposed by the federal government on the small business community and the American people.

Small business owners have a tremendous stake in the outcome of this debate. The economic goals of the Contract with America -- less taxes, spending, and regulation -- are what small business owners have wanted for years, as shown over and over again in NFIB surveys. In 1986, small business owners identified their federal tax burden as the third biggest problem facing their businesses, according to a study done in that year by the NFIB Education Foundation entitled *Problems and Priorities*. Then, a follow up study published in 1992 showed federal taxation moving up to the second biggest problem faced by small employers. And in a study completed by the NFIB Education Foundation in October of 1994, entitled *Small Business Economic Trends*, small business owners identified their tax burden as the number one problem facing their businesses.

In that same 1994 survey, regulation and red tape was identified as the second largest problem of small business owners, after holding the top spot in the previous survey. Finally, numerous surveys have shown over the years that **small business owners want the size and scope of the federal government scaled back, and that they want to balance the budget through spending cuts, not tax increases.**

NFIB members have been sending a clear message to every level of government in the country for years: **Get off our backs, out of our pockets, and off our land.** Throughout our testimony, we will make recommendations that we believe will make parts of the Contract more small business friendly, but **it is important to state NFIB and its members support the Contract enthusiastically and embrace its goals.**

Small Business: America's Path to Jobs and Independence

Small business has a huge stake in the outcome of your deliberations on the elements of the Contract before this committee. It is equally true that America as a whole has a huge stake in how small business fares in whatever tax and economic legislation this committee reports. Evidence continues to clearly suggest that small business plays a unique and rather remarkable role as a job creator and provider of personal opportunity, security and independence for millions of Americans. Consider the following:

Jobs. Since the early 1970s, small firms have created two of every three net new jobs Bin this country (created jobs minus lost jobs). A substantial majority of that job growth came in the very smallest firms -- those with fewer than five employees. The nation's small business job machine has shown a capacity to produce in either good or tough times. **From 1989 to 1991, a period of minimal economic growth, firms with fewer than 20 employees created all net new jobs in the country. Firms of all other sizes lost employment during that period.**

Demographics. Almost all businesses are small businesses. There are approximately five million employers in the United States. About 99% of them are small employers. And almost all small businesses are very small -- so-called Mom-and-Pop, Main Street, family enterprises. More than half of businesses with employees employ fewer than five people. Almost 90% of employers employ fewer than 20. Small business as a whole employs more than half of the private sector workforce. **Most small firms are not set up as C corps, but as proprietorships, partnerships, and subchapter S corporations.**

Values. Small business holds out to our citizens great hope. Small business offers a road map to the American dream that allows any American with a good idea and talent to follow it to economic freedom and security by starting their own business and working hard to make it a success.

It is this culture, these values, that primarily drive people to start a business -- not because they have money or want to make a lot of it. In a 1991 NFIB Education Foundation study entitled *New Business in America*, new business owners were asked why they went into business. Answers such as "Use my skills," "Control over my own life," and "Build for the family" were all cited twice as frequently by respondents than was "Earn Lots of Money." And having money to start with is not a distinguishing factor in wanting or being able to start a business and pursue the American dream. **More than half of all businesses begin with less than $20,000 in capital. One in four of *Inc.* magazine's 500 fastest growing companies in 1992 started with less than $5,000.**

None of this should lead you to believe that surviving as a small employer is easy. To the contrary, it is difficult. About half of all businesses do not survive the first five years.

There are numerous reasons why businesses fail. One of them is government -- government taxes, government red tape, government regulations, and government paperwork. That is why what you do here in the first 100 days of the 104th Congress is so important. You have a unique challenge and opportunity -- an opportunity to free small business owners and entrepreneurs from the drag of government so they can do what they do best, create opportunity and wealth for the American people. The rest of this testimony will look at how the Contract and the changes it makes in tax policy can foster further small business creation, growth, opportunity and jobs.

Small Business and Tax Policy: What's Important

Before examining individual items in the Contract with America, I would like to propose a set of criteria by which you can judge the value of tax cuts and reforms to small business owners. Of course, every business owner, regardless of the size of their business, wants to pay less in taxes. **But it would be a mistake for you to think that both the small and large business owners would always agree about how to deliver tax relief.** Small business owners face a unique set of problems running their businesses, and they want a tax code that either reduces those problems, or at the very least does not aggravate them.

When making your decisions about how to cut taxes, NFIB and its members hope that you would think about what we call the Three C's of small business and taxes: Complexity, Cash Flow and Capital Formation.

■ **Complexity is the bane of small business owners.** Most perform numerous roles within their business -- manager, marketer, sales associate, benefits administrator, bookkeeper and accountant. Unlike large firms, there is no legal counsel down the hall to read new IRS regulations. There is no software, and in many cases, no computer, to assist in properly depreciating a piece of equipment or figuring out the alternative minimum tax. And in many cases, a small employer cannot afford to consult an accountant or tax advisor to help determine the best way to utilize the tax code. **Tax regulations and paperwork destroy small businesses.**

In 1992, the burden of regulation and paperwork was the fastest rising problem identified by the NFIB Education Foundation's *Problems and Priorities* study, registering as one of the top ten problems for small business. In 1994, regulation and paperwork topped the list of small business problems for a time, and remains second today. Why is this significant for this committee's deliberations? Because the IRS is by far <u>the biggest</u> paperwork and regulatory problem for small business owners -- bigger than OSHA, EPA, DoL, and others. **Regulations and paperwork associated with paying taxes are in and of themselves a tax -- a regressive tax that is higher per capita on small firms than on large firms.** For these reasons, reducing the complexity of our tax code for small firms has been a major NFIB goal for years and a lens through which we believe this committee should look at tax proposals in the Contract.

■ **Cash flow, not profit, is the key to starting a successful small business.** In *Problems and Priorities*, cash flow ranked as the third highest problem for small business, behind only the cost of health insurance and federal taxation. Coming up with the cash to pay bills and make payroll is a constant challenge in a small firm. For tax policy, this means that small firms would rather deposit less taxes in the first place, than reclaim them later through deductions or credits. Money left in the business -- cash flow -- is the difference between life and death for most new businesses.

■ **Once a small firm is sure it will survive, obtaining funds for expansion and growth -- capital formation -- becomes important.** Small firms have fewer capital formation options than large firms -- they cannot raise money through the securities and financial markets and must get their capital from the business itself, from the bank, or from family members and associates. Because many small businesses are founded with investments in human capital rather than physical capital, the banking system has a more difficult time evaluating the risks involved correctly. Therefore, banks are also an inadequate source of capital, at excessively high interest rates and short maturities -- stifling much entrepreneurial talent.

Shortages of capital was listed as a top concern of small businesses in both the 1981 and 1986 White House Conferences on Small Business and continually appears at the top of NFIB surveys of its members. Most recently, it has consistently been a top priority in the state conferences leading up to the 1995 White House Conference on Small Business. Small businesses need tax changes that will create incentives for investment in small firms by both investors and business owners themselves.

Beyond the three C's, NFIB and its members have two additional criteria for judging the proposed tax cuts in the Contract. First, will a proposed tax cut promote economic growth and job creation? And second, is the proposed tax cut fiscally responsible, with potential revenue losses offset by spending reductions?

With these criteria in mind, here is how NFIB views tax proposals in the Contract with America:

<u>The Job Creation and Wage Enhancement Act</u>

The Job Creation and Wage Enhancement Act consists of six basic parts: (1) a small business appreciation package; (2) capital gains reform; (3) neutral cost recovery; (4) taxpayer debt buydown; (5) private property rights; and (6) regulatory impact analysis. Beyond stating that the regulatory relief and property rights initiatives are supported by and of vital importance to NFIB members, I will limit our specific comments to those items within the committee's jurisdiction.

Small Business Appreciation

NFIB greatly appreciates and supports the provisions contained in the small business appreciation portion of the bill, and its inherent acknowledgement of the role small business plays in the economy. Each provision of the small business appreciation package touches upon issues that NFIB has worked on for years, and we are happy they will be voted upon in the House.

Current law allows businesses to fully deduct the first $17,500 they invest in equipment in the year it is purchased. The Contract with America would raise that limit to $25,000 a year. **Small firms like expensing for several reasons: it is simple; it helps cash flow; and it encourages capital formation.**

Expensing allows small firms to escape the complexity associated with figuring out and tracking the depreciation schedules for many different pieces of equipment. Expensing deals with the cash flow problems faced by small firms by allowing them to deduct more up front -- putting those dollars back in the hands of the business faster, instead of keeping it in the hands of the government. Expensing helps the small business owner who needs working capital as well as the entrepreneur who is looking to expand or strengthen the business through the purchase of an important piece of equipment. And finally, expensing is good for the economy. If businesses are allowed to write-off their investments in the year they are purchased they are much more likely to make such investments, thereby increasing growth and jobs.

NFIB believes that increasing expensing is the best tool this committee has to encourage investment by small and medium size firms. In fact, we believe expensing is a far better way to encourage investment by these firms than the neutral cost recovery proposal in the Contract. As a result, NFIB proposes placing more emphasis on your expensing proposal as a way of keeping the promises and goals of the Contract with America. Specifically, **NFIB proposes raising the expensing limit to $100,000 per year.** We believe this would be a tremendous step for small business and the economy as a whole, leading to substantial growth.

A second feature of the small business appreciation package is the home office deduction. This proposal addresses the decision made by the Supreme Court in its Soliman decision a few years ago, in which the court placed new limits on the ability of business taxpayers to take the home office deduction.

This issue is very important to continued small business creation and growth. NFIB and its members. Home based businesses are the cradle of many successful enterprises both large and small. Home-based businesses will continue to increase in the information age, with fax machines and modems making it more feasible. In addition, a home based business is an increasingly attractive option for two wage earner families in which one parent would like to be at home with the children. The home business path to independence and income should not foreclosed because of the ongoing controversy over how and whether such a business deducts its expenses.

Much of the controversy over who can take this deduction centers on the reference in Section 280A of the Internal Revenue Code to the home office deduction being taken on a portion of a home that is the "principal place of business," and the ambiguous and subjective nature of that phrase. The Job Creation and Wage Enhancement Act rightly attempts to clear up that ambiguity by more clearly defining "principal place of business" as (1) the location where the taxpayer's essential administrative or management activities are conducted on a regular and systematic basis; and (2) the office is necessary because the taxpayer has no other location to perform these administrative and management activities.

NFIB supports your proposal. It is a big step in the right direction. We have had some concern that it may leave too much subjectivity remaining on criteria for taking the deduction, but we have been pleased with the committee staff's willingness to listen to these concerns and its willingness to further clarify Congress's intent with report language.

The final section of the small business appreciation package provides estate tax relief for farmers, ranchers, and small business owners. NFIB believes that estate tax reform is crucial to the continued survival of small businesses in America, and we commend the Contract's authors for including it. We also urge the committee to expand its vision on this issue and to consider protecting all closely held farms, ranches and small businesses from destruction by the IRS.

Current estate tax rates cripple a small business passed on to heirs, and often force them to liquidate a business they have worked in their whole lives. High estate taxes may provide government revenue in the short run, but the long-run losses far outweigh the gains -- a productive business is extinguished, many jobs are lost, and the American dream of growing a business and preserving it beyond one's lifetime by passing it on to heirs becomes impossible to achieve.

Consequently, NFIB strongly supports the Job Creation and Wage Enhancement Act proposal to raise the estate tax exemption from $600,000 to $750,000, and to index the exemption to inflation. It is a very needed first step. **We further propose that the value of closely-held business, farm and ranch assets in an estate be exempted from estate taxes altogether.**

Exempting closely-held business, farm and ranch assets from estate taxes would ensure that the business will continue and that the jobs of its employees will be protected. Moreover, this exemption would eliminate the strong disincentive that now exists for business owners to continue to develop their business and create jobs as they reach their later years in life. A recent study by the Tax Foundation found that today's estate tax rates have the same disincentive effect on entrepreneurs as a doubling of current income tax rates.

Because all assets are included in determining estate tax calculations, many productive businesses worth even far less than the current exemption level become victims of the estate tax. Because so many small businesses operate on cash flow, often with extremely small or negative profit margins, current law allowing small businesses to spread their tax liability over ten years does not provide adequate relief. Unlike a publicly traded corporation, which exists beyond the lifetime of even major shareholders because stock can simply be sold on the public exchange, closely held businesses are devastated by the death of an owner.

Total federal estate tax revenue represents only about $10 billion annually. Business assets represent roughly 12.3% of this $10 billion -- about $1.23 billion a year. **In other words, for $1.23 billion annually, every closely held farm, ranch, and small business in America could be exempt from the federal tax collector's axe.**

Capital Gains Tax Reform

NFIB supports cutting capital gains taxes to encourage investment and job creation. Because of the particular difficulties small businesses have in obtaining capital, as discussed earlier, a capital gains cut would be beneficial to the growing portion of our nation's small businesses, and, in turn, our nation's economic growth.

Consequently, NFIB strongly supports the Job Creation and Wage Enhancement Act's proposal to exclude 50 percent of a capital gain from taxation, and to index the capital gains tax rate to inflation (in an October 1994 survey, 69% of NFIB members supported indexing capital gains for inflation). The Microsofts and WalMarts of the world were resourceful or lucky enough to overcome significant capital formation hurdles. Unfortunately, many other potential success stories will never be told because of lack of capital. Adopting the capital gains tax cut proposal in the Job Creation and Wage Enhancement Act will free currently frozen supplies of investment capital which will fuel small business and economic growth for years to come.

Additionally, because of the unique difficulties small businesses face in obtaining capital discussed earlier (lack of access to the securities market, difficulty in getting bank loans, etc.), **we would further propose a complete exemption from capital gains taxes on targeted equity investments made in small businesses that are held for a certain length of time.** A targeted small business capital gains tax cut is certainly not a new notion. In 1989, Senator Bob Packwood, Congressman Bob Matsui and others introduced bills providing for a rate reduction targeted to small business venture capital investments held for certain lengths of time. The

proposal was supported in 1992 by presidential candidates Bush and Clinton but, although included in the 1993 Budget Reconciliation Act, was substantially gutted by limiting amendments. Fixing this language to eliminate these limitations and expanding the scope of qualified small business investments will help target investment in small firms and unleash their economic potential.

Neutral Cost Recovery

Neutral cost recovery (NCR), as proposed in the Job Creation and Wage Enhancement Act, would adjust current depreciation allowances both for inflation and the time value of money (approximately 3.5% -- which has been the average return on capital in the U.S. for over a century). Firms would continue to write-off assets over a period of years, but future depreciation allowances would be increased by the rate of inflation and a percentage equal to the real discount rate. If done correctly, firms would ultimately be able to deduct the full real present value of their investments, in the end achieving the economic equivalent of expensing.

Neutral cost recovery addresses a worthy goal. But there are several reasons why the proposal is far less beneficial to small firms than it is to larger firms. First, it is more complex and more difficult to understand and use. As mentioned earlier, small business owners find the process of depreciation complicated, cumbersome, and sometimes costly. Second, because of cash flow problems, small business prefers write-offs to be front loaded instead of back loaded. That is, the quicker the deductible costs of an investment can be recouped, the better. Neutral cost recovery takes a reverse approach. It <u>reduces</u> the deductibility of depreciable assets in the early years while <u>increasing</u> it in the later years. This reduction in the early years is not helpful to small firms whose major short term need is cash for operating costs, and the higher deductions in the later years only benefits the relatively few small firms that purchase longer term depreciable assets.

NFIB does not oppose neutral cost recovery, particularly when done in combination with a substantial increase in expensing. However **we do believe that increasing expensing to $100,000 would do a far better job of accomplishing the promises and goals of the Contract -- increasing investment and jobs -- and doing so in such a way that is far more beneficial to small firms.**

Taxpayer Debt Buydown

The Job Creation and Wage Enhancement Act would allow taxpayers to designate up to 10% of their tax liability to be used to reduce the federal debt. Congress would then be required to cut government spending by an equal amount. NFIB strongly supports the taxpayer debt buydown included in the Contract. In a June 1993 survey, 78% of NFIB members said they supported this exact proposal, and deficit reduction has been one of the top concerns of small business owners in NFIB surveys for years.

<u>The American Dream Restoration Act</u>

The American Dream Restoration Act is a three pronged approach to middle class tax relief: (1) a $500 per child family tax credit; (2) reform of the marriage penalty; and (3) tax deductible Individual Retirement Accounts with penalty-free withdrawals for certain specified uses. NFIB very much supports the Contract's inclusion of middle class tax relief. We would like to offer some suggestions today about how exactly this should be done.

Small business owners have two basic reasons for supporting a middle class tax cut. First, contrary to the stereotype put forward by some, most small business owners are part of the middle class, whether they are struggling entrepreneurs taking small salaries to stay afloat or the owners of growing businesses plowing profits right back into the firm. NFIB statistics show that the typical NFIB member takes home less than $40,000 a year. This, combined with the earlier mentioned survey results showing deep small business concern about taxes, clearly illustrates how small business would benefit from middle class tax relief. Secondly, small business benefits from the positive economic effects whenever money that would have been in the hands of government is instead left in the hands of the American taxpayer and consumer.

I would like to suggest, however, a different vehicle for delivering on the Contract with America's promise of middle class tax relief -- a way more beneficial to a broader slice of the middle class and to small business owners. **The middle class tax cut most supported by NFIB members is an individual tax rate reduction, as was proposed by Speaker Newt Gingrich and Majority Leader Dick Armey in the final days of the 103rd Congress. Their proposal would reduce individual tax rates by about 20 percent across the board.**

NFIB believes that a tax cut should be neutral -- benefiting those with children as well as those without. We agree wholeheartedly that taxes are too high -- but they are high for everyone. A rate reduction would deliver the broadest possible benefit to the middle class. Furthermore, the most important tax priority of small business owners over the years has been low rates. NFIB members believe, whether they have children or not, that their tax burden is too high and should be lower. Eighty percent of Americans reporting business income on their tax forms are unincorporated, meaning that their business pays individual tax rates, not corporate tax rates. The best way to deliver a tax cut to them and their employees, as well as to every middle class American is through a tax rate reduction.

Looking Beyond the Contract With America

The tax provisions of the Contract with America are bold, far reaching, and, as stated earlier, move in a direction strongly supported by small business. But we agree with statements made by you, Mr. Chairman, as well as Speaker Gingrich, that the Contract is an important beginning, not the entire agenda. With this in mind, I would like to take this opportunity to present to you items on NFIB's tax reform agenda for small business that are not part of the Contract with America. NFIB believes that some of the issues we will mention could and should be included in your 100 day agenda -- simply because they are so urgent and are such natural extensions of the Contract.

As I have already stated, NFIB proposes (1) exempting all closely held business, farm and ranch assets from estate taxes; (2) exempting investments in firms under a certain size from capital gains taxes; and (3) increasing expensing to $100,000.

Health Insurance Tax Deduction for the Self Employed

The 25% deduction that self-employed business owners receive for their health insurance premiums expired on December 31, 1993. The 103rd Congress failed to renew it for 1994. Unless you act before April 15, when taxes are due, the self-employed will learn that they have lost their deduction while corporate executives retain a full 100 percent deduction simply because they work for C corps. NFIB strongly urges you to restore the self-employed deduction retroactively within the first 100 days, and Mr. Chairman, the small business community applauded published reports in December reporting your commitment to getting this done.

The 25% deduction has been temporarily extended from year to year since it was first enacted in 1986. It has repeatedly been held hostage to other, typically very unpopular causes like the tax increases in 1990 and 1993, as well as the Clinton health care plan last year. The deduction is a small but meaningful incentive for unincorporated business owners - sole proprietorships, partnerships, and subchapter S corporations -- to purchase health insurance for themselves and their families. If this group of business owners were given the same, long overdue, 100% deduction for their health insurance premiums that C corps receive, many would purchase insurance, substantially reducing the number of uninsured Americans in this country. **Self-employed Americans are one of the largest groups of uninsured citizens.** There are nearly three million self employed Americans without health insurance.

Mr. Chairman, NFIB urges the committee to retroactively restore the 25 percent deduction to the self-employed and to send a clear signal that business as usual is a thing of the past by increasing the deduction to at least 50 percent and making a commitment to reaching parity as soon as fiscally possible. There is simply no reason to continue this blatant discrimination against self-employed business owners.

Simplified Accounting Method and SBEZ Tax Form

The real complexities of the tax code for small business lie in the increasing variety of accounting methods (at least eight) an owner must be familiar with to complete and file a tax return. This complexity is a major hurdle to compliance -- turning traditionally honest business owners into tax evaders because they do not know or understand the tax rules with which they must comply. To address this, **NFIB supports simplified accounting methods for firms under $10 million in gross annual sales in the following areas: cash accounting, full expensing of all assets and bad debts, simplified rules for deduction of meals and automobile expenses and a full exemption from alternative minimum tax (AMT) calculations.** NFIB would welcome the opportunity to work with the committee to further develop such a meaningful proposal.

For similar reasons, NFIB would like to work with this committee to create a simplified small business tax form, or an SBEZ form based on the 1040 EZ form for individuals. The Internal Revenue Code is 1,339,000 words long. With its complicated accounting rules and calculations it has become a quagmire for small business owners, many of whom do their own taxes. We urge this committee to pass legislation instructing the IRS to create a simplified SBEZ tax form designed for the use of small business owners.

Simplified Small Business Pension Plan

The rising administrative costs and legal complexity of pension plans are forcing small business owners to drop their pension plans in ever increasing numbers. For the same reasons, many newer businesses are unable to set up such plans. Current law already allows employers to set up Simplified Employee Pensions (SEPs). However, even SEPs are complex to administer, and as a result they have not been effective in encouraging small business owners to establish pension plans.

NFIB supports enactment of a new pension system that will encourage small business owners and their employees to save for their retirement. A simplified pension plan should be available to all employees, contain no non-discrimination or participation rules, and be flexible enough that it will appeal to a wide variety of employers. NFIB has in the past supported a bill offered by Senate Finance Committee Chairman Bob Packwood that would simplify the pension system and we continue to do so. Again, NFIB looks forward to working with you, Mr. Chairman, on this important issue.

Safe Harbor for Independent Contractors

The definition, for tax withholding and other purposes, of who is an employee and who is an independent contractor is so complex that it is difficult for employers to know when they are violating it. In addition, it can make it difficult for independent contractors -- small businesses themselves-- to exist at all because of fear of an IRS audit. A mistake or disagreement over how to classify a worker with the IRS can mean audits, legal expenses, and fines. This can be very expensive, enough in some instances to close a business for good. **The definition of who is an independent contractor should be clarified by Congress with a new safe harbor.** NFIB strongly supports the creation of a new safe harbor with a few simple tests that will allow an employer to easily determine who is an independent contractor and who is not. In past Congresses, NFIB has proposed language to create such a safe harbor, and we would like to work with the committee to make this major simplification of the code happen.

Conclusion

Mr. Chairman, I want to thank you again for this opportunity to testify before the Ways and Means Committee. I also want to thank you for starting this Congress in such an impressive fashion -- with an aggressive agenda that offers tax relief, regulatory relief, and a commitment to fiscal discipline. Again, the message small business owners everywhere are sending to government is: Get off our backs, out of our pockets, and off our land. On behalf of the more than 600,000 small business owners of NFIB, I want to express my hope that we can work together to enact this kind of agenda, and I hope you will consider the specific suggestions we have offered to help achieve the goals of the Contract for America.

Thank you, Mr. Chairman.

Mr. BUNNING. Mr. Huard.

STATEMENT OF PAUL R. HUARD, SENIOR VICE PRESIDENT, POLICY AND COMMUNICATIONS, NATIONAL ASSOCIATION OF MANUFACTURERS; ACCOMPANIED BY GIL THURM, VICE PRESIDENT, TAXATION AND ECONOMIC POLICY

Mr. HUARD. Thank you, Mr. Bunning. I appreciate the opportunity to testify on selected tax provisions of the Contract With America on behalf of the National Association of Manufacturers and our 13,000 members, over 8,000 of whom are smaller firms with under 500 employees.

Since the hour is late, I will submit my complete statement for the record and try to summarize as much as I can.

Let me begin by noting that the Federal tax system, as we know it today, contains a number of grave deficiencies. Among the principal ones are these: First, it relies excessively on the taxation of income from work, savings and investment, and often subjects such income to multiple levels of taxation.

Second, both entrepreneurial risk taking and the free flow of capital are significantly deterred by excessively high rates of taxes on capital gains.

Third, for business taxpayers, especially those in capital intensive industries that are trapped by the alternative minimum tax or who are subchapter S corporations, the capital cost recovery system for investment in plant and equipment is among the worst in the industrialized world.

Fourth, the foreign-source income of U.S. firms is taxed much more harshly than that of competing firms in other industrialized countries, imposing a major competitive disadvantage in many cases.

Fifth, the national savings rate is scandalously low, not only limiting the amount of investment capital available to create new jobs, but also placing additional strains on the Social Security system.

Finally, the Federal income tax system, as it exists today, is abysmally complex, resulting in the certain waste of scores of billions of dollars every year in wholly unproductive compliance costs.

Given the serious problems I have outlined, the NAM is pleased to note that the Contract With America contains a number of suggested changes that would effectively address some of these problems. These include, first, the fact the Contract would cut capital gains taxes and inflation index the cost basis of capital assets. The NAM has long been an enthusiastic supporter of such changes.

Second, the Contract would provide incentives for putting money into individual retirement accounts. The NAM has been a consistent supporter of IRA expansion as one desirable way to improve the national savings rate. For the longer term, however, there will still be a need for overall structural reforms that will eliminate the multiple levels of taxation on an earned dollar that is then saved or invested, and second, that will properly integrate the corporate and individual tax systems.

The Contract would also furnish much needed relief for small businesses by expanding the estate and gift tax exemption and by increasing the amount of capital investment that may be expensed rather than depreciated.

There is, however, a glaring omission here. No relief is provided here for the excessively high rates of tax paid by subchapter S shareholders on retained earnings that are reinvested in the business, and we strongly urge that you deal with this problem as part of the Contract.

The Contract would improve the existing depreciation system by moving toward the economic equivalent of expensing through the neutral cost recovery system. While the goal here is a laudable one, there are a number of overriding issues you need to consider. One is that the NCRS does not realistically address the fact that many capital intensive industries contain many companies that are trapped in the alternative minimum tax and would continue to be even with the NCRS.

Indeed, a more appropriate short-term attempt at improving the capital formation climate might be a substantial reduction in the impact of the alternative minimum tax on depreciation, or even outright repeal of the AMT.

As a long-term goal, outright expensing is probably more desirable than the economic equivalent of expensing. Many firms, particularly smaller ones, are forced to live off their cash flow and, for them, calculating the present value of a stream of future deductions does not really generate much in the way of spendable funds.

In closing, I would make two overarching recommendations. First, any tax cuts enacted as part the Contract should be fully funded by offsetting spending reductions. Failure to do so would almost inevitably lead to a rise in interest rates that would negate the positive effects of such tax cuts.

Second, while the Contract's tax provisions are in many respects desirable in the short run, they are nevertheless a piecemeal approach and leave unresolved many of the problems of the current tax system. We therefore should not lose sight of the continuing need for a complete overhaul of the Federal tax structure, and we urge you to start work on such an effort as soon as you have completed your work on the tax provisions of the Contract.

Thank you.

[The prepared statement follows:]

OVERVIEW OF SELECTED PROVISIONS OF
THE "CONTRACT WITH AMERICA"

TESTIMONY OF THE
NATIONAL ASSOCIATION OF MANUFACTURERS
BY PAUL R. HUARD
SENIOR VICE PRESIDENT, POLICY AND COMMUNICATIONS

BEFORE THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

JANUARY 12, 1995

The National Association of Manufacturers (NAM) is a voluntary business association of more than 13,000 firms, large and small, located in every state. Our members range in size from the very large to the more than 8,000 smaller members that have fewer than 500 employees each. The NAM's member companies employ 85 percent of all workers in manufacturing and produce more than 80 percent of the nation's manufactured goods.

We appreciate this opportunity to testify on provisions contained in the "Contract With America" that are within the jurisdiction of the Ways and Means Committee. Since today's hearing is in the nature of an overview, my testimony will accordingly be quite general.

The federal tax system as it exists today has a number of grave deficiencies. Among the principal ones are these:

- Overall, it relies excessively on the taxation of income from work, savings and investment, and often subjects such income to multiple levels of taxation. A dollar earned is taxed and, if the remainder is saved or invested, the earnings or gains on that savings or investment are taxed yet again. Similarly, a dollar of corporate earnings is taxed under the corporate income tax and, if then paid out to a shareholder, immediately taxed again under the individual income tax.

- Both entrepreneurial risk-taking and the free flow of capital are significantly deterred by excessively high rates of tax on capital gains. In the case of long-held assets where much of the so-called "gain" is the result of inflation, the tax is confiscatory and can actually exceed the taxpayer's real economic gain.

- For business taxpayers, especially those in capital-intensive industries who are subjected to the alternative minimum tax (AMT), our capital recovery system is among the worst in the industrialized world. This limits the ability of many firms to make job-creating investments. A similar problem exists with Subchapter S corporations whose retained earnings are subjected to unreasonably high tax rates.

- The foreign source income of U.S. firms is taxed much more harshly than that of competing firms based in other industrialized countries, imposing a major competitive disadvantage in many instances.

- The national savings rate is scandalously low. This not only limits the amount of investment capital available to new and existing businesses but also places additional strains on the Social Security system, the long-term viability of which is highly questionable given current demographic trends.

- Finally, the federal income tax system as we know it today is abysmally complex, resulting in the certain waste of scores of billions of dollars every year in wholly unproductive compliance costs. There is a growing view that the system is now so bad that it can't be fixed and instead should just be scrapped and replaced with something new.

Given the serious problems outlined above, the NAM is extremely pleased to note that the "Contract With America" contains a number of suggested changes to the nation's tax laws that would address these problems in a positive manner. These include:

- Cutting capital gains taxes and inflation-indexing the cost basis of capital assets. The NAM has long been an enthusiastic supporter of both such changes.

- Providing additional incentives for putting money into individual retirement accounts (IRAs). The NAM has been a consistent supporter of IRA expansion as one desirable way to improve the national savings rate. For the long term, however, there will still be a need for overall structural reforms that (1) will eliminate the multiple levels of taxation on an earned dollar that is saved or invested and (2) will properly integrate the corporate and individual tax systems.

- Furnishing much-needed relief to small businesses by expanding the estate and gift tax exemption and increasing the amount of capital investment that may be expensed rather than depreciated. There is, unfortunately, a glaring omission here. No relief is provided from the excessively high rates of tax paid by shareholders of a Subchapter S corporation that retains and reinvests its earnings, and we strongly urge that you deal with this problem as part of the Contract's package of small business reforms.

- Improving the depreciation system by moving towards the economic equivalent of expensing -- the Neutral Cost Recovery System (NCRS). While the goal here is laudable, there are a number of overriding issues that you should consider. One is that the NCRS does not realistically address the fact that many capital-intensive taxpayers end up trapped in the alternative minimum tax (AMT). Indeed, a more appropriate short-term reform might be substantial reduction of the impact of the AMT on depreciation or, even better, outright repeal of the AMT. Moreover, as a long-term goal, outright expensing is probably more desirable than the economic equivalent of expensing. Many firms are forced to live off their cash flow and for them calculating the present value of a stream of future deductions doesn't generate spendable funds.

In closing, I want to make two overarching recommendations:

First, any tax cuts enacted as part of the Contract should be fully funded by offsetting spending reductions. Failure to do so will almost inevitably lead to a rise in interest rates that will negate the positive effects of such tax cuts.

Second, while the Contract's tax provisions are in many respects desirable in the short run, they are a piecemeal approach which leave many of the problems of the current federal tax system -- which I outlined at the beginning of this testimony -- substantially unresolved. In some cases, such as the complexity issue and the overly harsh treatment of foreign source income, the problems are not even addressed. You therefore should not lose sight of the continuing need for a comprehensive overhaul of the federal tax structure and we urge you to start work on such an effort as soon as you have finished dealing with the "Contract With America."

This concludes my prepared testimony, Mr. Chairman. We would be pleased at this time to address any questions you or other members of the Committee might have.

Mr. BUNNING. Thank you.
Mr. Friedman.

STATEMENT OF SHELDON FRIEDMAN, ECONOMIST, ECONOMIC RESEARCH DEPARTMENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. FRIEDMAN. Thank you. I appreciate this opportunity to testify on behalf the AFL–CIO. You have my complete statement, which I request be printed in the record of this hearing.

The central concerns of working people today are job security and good wages and for good reason, and it is through the lens of these concerns that the AFL–CIO views the tax proposals of the Contract With America. And viewed through this lens, we do not feel that the major provisions of the Contract in the tax area will move us toward these goals.

The case simply has not been made that the major cuts in the area—for example, of capital gains, depreciation and so forth—will create any good new jobs, in particular good jobs here in the United States.

But while that is an unknown, what is well known and quite clear is that these and many of the other provisions will deprive the Nation of badly needed revenue while providing wealthy individuals and corporations with massive tax breaks which they neither need nor deserve.

Several of the provisions of the Contract, notably the capital gains tax cut, the neutral cost recovery depreciation proposal and the "American dream savings account" super-IRA proposal are, in our view, fiscal time bombs that would cause huge revenue losses down the road.

Beyond the inequity of the distributional effects of these proposals, the real concern that we have is, how would these tax cuts be financed? We are very concerned that it will be done by terminating necessary Federal programs. The AFL–CIO is, therefore, strongly opposed to consideration of tax cuts before the budget offsets are known.

The capital gains tax cut, in our view, is especially unjustified. Income from capital gains is already taxed at highly preferential rates. Further cuts would make a bad situation even worse. This preference for capital gains is inherently unfair to working people whose wages would be taxed at a higher rate than profits of wealthy individuals on the sale of their stocks and bonds.

The fact of the matter is that some 93 percent of all the tax returns in the country today report zero income from capital gains. More than two-thirds of the benefit from this preference would accrue to those wealthy individuals with incomes of more than $200,000 a year. We are talking about the richest 1 percent in the country. And nothing in the Contract would change this skewed distribution of the benefits from capital gains.

The deep cuts, 50-percent cut plus indexing would exempt some two-thirds of all capital gains income from taxation, would lead to revival, in our view, of the tax shelter industry with all the attendant waste and attempts to shift ordinary income into capital gains for no other reason than the avoidance of taxes.

The neutral cost recovery proposal and other tax breaks for corporations, in our view, are not justified either. U.S. corporations already are taxed at a lower rate than their competitors in Germany and Japan. If you look at the proportion of Federal revenues derived from corporate income taxes, they have declined every decade in succession since the fifties.

Back in 1953, 31 percent of Federal revenues were derived from the corporate income tax; 20 years later, in 1973, that proportion had fallen to 16 percent. And by last year, only 9 percent of Federal revenues were derived from the Federal income tax. Clearly, this is not an area where further tax cuts are justified or needed.

Nor do we feel the estate and gift tax exemption should be increased. Only 25,000 estates in the entire country today, roughly 1 percent of the total, pay any tax at all under this very generous $600,000 exemption that exists. I ask you to compare that exemption with median net worth, which is about $36,000 in this country. Who is it we want or need to help by raising this exemption? The proportion of Federal revenues that has been derived from the estate and gift tax has been cut in half in the last 20 years. Today it raises only about 1 percent of all our Federal revenues. It was more than 2 percent back in the mid to late seventies.

With regard to the fundamental issue of the family tax credit, which would provide modest but welcome relief to moderate-income families with children, but would ignore workers without children, we have several concerns. Families with incomes above $200,000 or at that level don't need a tax cut. Under the proposal in the Contract, they would get it.

But the real issue is—and I will try to wrap up; I am mindful of the time—how would this tax relief be paid for? If working Americans could get tax relief financed by closing wasteful, job-destroying loopholes—and we have a list of them attached to our statement—if there were a way that could be done, there would be no question about the desirability of such tax relief. But that is not the choice being offered by the Contract With America.

It will do little good for working families to give them a $500-per-child tax credit while cutting back on aid to education or student loan programs. It will do little good to those who are anxious that they may lose their jobs to give them a tax credit while at the same time slashing retraining programs that could help them if they lose their jobs.

It will do little good to give workers a tax credit and then have the Federal Reserve take that as a signal to raise interest rates to slow the economy, throw them out of work and raise their mortgage payments and student loan payments and car payments. These are some of our most fundamental concerns.

I thank you for this opportunity to testify. There are many issues that I have not covered, such as the welfare reform provisions of the Contract, which we hope to address at a later time. Thank you.

[The prepared statement and attachments follow:]

STATEMENT OF SHELDON FRIEDMAN, ECONOMIST
ECONOMIC RESEARCH DEPARTMENT
AMERICAN FEDERATION OF LABOR
AND
CONGRESS OF INDUSTRIAL ORGANIZATIONS
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
ON THE "CONTRACT WITH AMERICA"

January 12, 1995

The AFL-CIO welcomes this opportunity to present its views on the tax provisions of the House Republican "Contract With America." The central concerns of working people today are job security and good wages. The current economic expansion has created many jobs, but it has done little to alleviate economic insecurity or reverse the fifteen year slide in real wages.

The fundamental question that the AFL-CIO urges this Committee to ask is: will a family tax credit of $500, a new backloaded IRA, a new capital gains tax preference, or a new more generous depreciation schedule really help provide the long-term, well paying jobs and the economic security that American workers need and deserve?

Taken as a package, the tax provisions of the Contract do not meet these objectives. Instead, they would deprive the nation of badly needed revenues, while providing the wealthy and corporations with massive ill-deserved tax breaks.

According to Treasury Department estimates, the tax provisions of the Contract would reduce federal revenues by $205 billion over the next five years. These initial revenue losses, moreover, are just the tip of the iceberg. Between 1995 and 2005, the nation would hemorrhage $725 billion in lost revenues. Several of the Contract's provisions, notably the capital gains tax cut, the so-called "neutral cost recovery" depreciation proposal, and the "American Dream Savings Account" IRA proposal, are fiscal time bombs that would lose relatively little revenue at first, while causing a huge revenue drain down the road.

The beneficiaries of most of this tax cutting largesse would be corporations, and individual taxpayers at the very top of the nation's increasingly unequal income and wealth pyramid. Again according to Treasury Department estimates, 54% of all the proposed tax cuts would accrue to taxpayers with incomes above $100,000 per year, the richest five per cent.

Beyond the enormous revenue loss and the inequitable distribution of the proposed tax cuts, the AFL-CIO has serious concerns about how the cuts would be financed. The elaborate detail of many of the tax provisions of the Contract that are before this Committee stands in sharp contrast to the Contract's failure to identify specific spending cuts to pay for them. The AFL-CIO is mindful of Chairman Archer's insistence that all tax reductions must be paid for before they are enacted. However, we are very concerned that this reasonable approach will be accomplished by terminating necessary federal programs. While it is true that a high proportion of the American public express understandable frustration to pollsters by advocating less government, most do not favor cuts in specific programs such as education, transportation or health care, and with good reason. Such programs can have a far greater bearing on their quality of life than a tax cut, particularly a tax cut that will accrue primarily to corporations and the well to do. The AFL-CIO is therefore opposed to the consideration of tax cuts before the budget offsets are fully known.

The possibility that a balanced budget amendment to the Constitution may pass, requiring deep and as yet unspecified spending cuts if it does, renders even more problematic the financing of the Contract's proposed tax cuts.

The claim in some quarters that the tax cuts in the Contract would stimulate so much economic growth that revenues will actually increase is redolent of voodoo economics at its worst. A far more likely scenario is that the tax cuts will cause Chairman Greenspan and his

FOMC colleagues to become even more confirmed in their disastrous belief that higher interest rates and tighter monetary policy are required, in order to restrain the economy to the maximum 2.5% growth rate that they deem acceptable.

Capital Gains

Of the myriad ill advised tax cuts in the Contract, among the least justified and least fair to working people is the proposal to deeply cut taxes on capital gains. According to the Treasury Department, the proposed cuts in capital gains taxes would deprive the nation of $61 billion in revenues over the next five years, and would cost $183 billion between 1995 and 2005. The dogged insistence by some that deep cuts in capital gains taxes will not cause revenue losses is sheer economic nonsense.

Even without the new cuts proposed in the Contract, the income from capital gains is already taxed on highly preferential terms. The 1993 tax law changes which increased the top tax rate to 39.6% on amounts of taxable income in excess of $250,000 kept the top tax rate on capital gains at 28%, a full 11.6% lower. To make matters worse, a brand new tax preference was created which lowered the maximum tax rate on capital gains to 14% for certain new investments and certain newly issued stock.

The further reductions in taxes on capital gains proposed in the Contract would make a bad situation dramatically worse. Tax preferences accorded income from capital gains are inherently unfair. They result in taxing the wages and salaries of working people at a higher rate than the profits made by the wealthy on their sales of stocks, bonds, real estate and other property. It is a tax preference not available to most working men and women who pay the lion's share of taxes and who must meet their income tax obligations every payday.

The fact that 93% of all tax returns report zero income from capital gains underscores how skewed in favor of the rich this tax preference is. According to Joint Committee on Taxation estimates, more than two thirds of all the benefits from capital gains tax preferences accrue to taxpayers with incomes in excess of $200,000 per year. Nothing in the new capital gains proposal before this Committee would change this skewed distribution.

Cutting capital gains taxes will also stimulate the tax shelter industry, which is based heavily on schemes to convert ordinary income into preferentially taxed capital gains. The huge 50% differential, plus indexing, would exclude almost two thirds of capital gains from taxation. This will prove to be an irresistible lure to these wasteful, revenue losing and highly inequitable tax shelter activities.

Neutral Cost Recovery

The AFL-CIO strongly opposes additional tax breaks for corporations at this time. U.S. corporations are already taxed more lightly than their competitors in such highly successful industrial nations as Germany and Japan (see Appendix 1). Corporations have also shouldered a smaller proportion of the federal income tax burden in each successive decade since the 1950s. Corporate income taxes accounted for only 9% of federal revenues in 1993, down from 16% in 1973 and 31% in 1953 (see Appendix 2). Against this backdrop, there is no justification whatsoever for further deep cuts in the form of a "neutral cost recovery" depreciation scheme that will cost $120 billion in lost revenues over the next ten years, according to Treasury Department estimates.

Social Security

The "Contract With America" would phase out the 1993 increase from 50% to 85% in the percentage of Social Security benefits received by senior couples with incomes above $44,000 ($34,000 for senior individuals) that would be subject to federal income tax. The cost of this proposal would be $15 billion over the next five years and $49 billion between 1995 and 2005, according to Treasury Department estimates.

Since the revenues from the 1993 increase were earmarked for the Health Insurance Trust Fund, the AFL-CIO is concerned that its repeal will worsen the impending crisis of Medicare financing.

The proposed increase in the Social Security outside earnings limit to $30,000 by the year 2000 will result in an additional drain of $7 billion from the Social Security Trust Fund over the next five years. We oppose this change.

Estate and Gift Tax

The AFL-CIO strongly opposes increasing the estate and gift tax exemption. Revenues from the federal estate and gift tax fell from 2.1% of all federal revenues in 1977, to only 1% in 1992, despite an enormous increase in concentration of wealth during the 1980s. The main reason for plummeting revenues despite sharp increases in concentration of wealth was the even sharper increase in the estate and gift tax exemption, from $120,667 for 1977 to $600,000 starting in 1987.

The current exemption is so generous that only 25,000 estates paid any tax at all in 1991. The $600,000 exemption is more than sixteen times the $36,623 median net worth of all households. Even among older households, who tend to be richer, the $600,000 exemption compares with median net worth of $88,192 for households age 65 and up.

Increasing the estate and gift tax exemption to $750,000, as proposed in the Contract, would cost $6.7 billion in lost revenues over the next five years, and $20.7 billion between 1995 and 2005, according to Treasury Department estimates, for the exclusive benefit of the well to do. Rather than lowering estate taxes, the Congress should review this area. Why, for example, should capital gains in an estate escape all income taxes?

Family Tax Credit

The proposed Family Tax Credit would provide modest but welcome tax relief to moderate income families with children, but would ignore workers without children. It would also aid many families whose income is not so modest, and these are serious concerns regarding how it would be paid for. The full $500 per child credit would be available to families with adjusted gross incomes of up to $200,000 per year, and a partial credit would be available up to income levels of $250,000.

It is difficult to believe that families with incomes of $200,000 per year need or deserve a $500 per child tax credit. Families at this income level are among the richest one per cent in America. Extending eligibility this high in the income pyramid also swells the cost of the proposed family tax credit, estimated by the Treasury Department at $124 billion over the next five years, and $289 billion between 1995 and 2005.

A more serious problem is how the family tax credit would be paid for. It will do little good for working families to give them a $500 per child tax credit, while simultaneously cutting back on federal aid to education or student loan programs. It will do little good for working families anxious that their breadwinners may lose their jobs to give them a tax credit, while simultaneously cutting federal retraining programs that could help them if they did. It will do little good to give working families a tax credit, if the Federal Reserve takes this as a signal to raise interest rates, thereby slowing the economy, eliminating jobs, and boosting mortgage payments, car loan payments and student loan payments by as much as or more than the value of the tax credit.

If tax relief for hard pressed working families of moderate means could be paid for by closing unjustified, wasteful, job destroying tax loopholes of primary benefit to corporations and the wealthy, there would be no question about its desirability. Unfortunately, that is not the choice being offered to working people by the "Contract with America." Instead of closing existing tax loopholes, the Contract would open many new ones. The AFL-CIO must therefore express serious reservations about any family tax credit or other so-called middle class tax cut that would trigger harmful spending cuts, or interest rate increases by the Federal Reserve.

If, on the other hand, this Committee is interested in exploring loophole closings to finance tax relief for working Americans, the AFL-CIO would be pleased to offer specific and detailed recommendations. Examples can be found in appendices 3 and 4, attached to this statement.

If tax relief for working Americans could be paid for by closing existing tax loopholes, the AFL-CIO would interested in presenting its views to this Committee on the structure of that tax relief.

Conclusion

The AFL-CIO strongly opposes the tax provisions of the "Contract with America" which are of primary benefit to corporations and the wealthy, including the capital gains tax cut, "neutral cost recovery" depreciation changes, the increased estate and gift tax exemption, and most of the proposed IRA liberalizations, especially the so-called "American Dream Savings Account." These proposals would rob the nation of billions of dollars of badly needed revenues, make the tax system even less fair to working Americans, and yield little or no economic gain.

The AFL-CIO is concerned that the proposal to phase out the 1993 increase in the taxable portion of Social Security benefits received by upper income retirees would worsen the looming Medicare financing crisis.

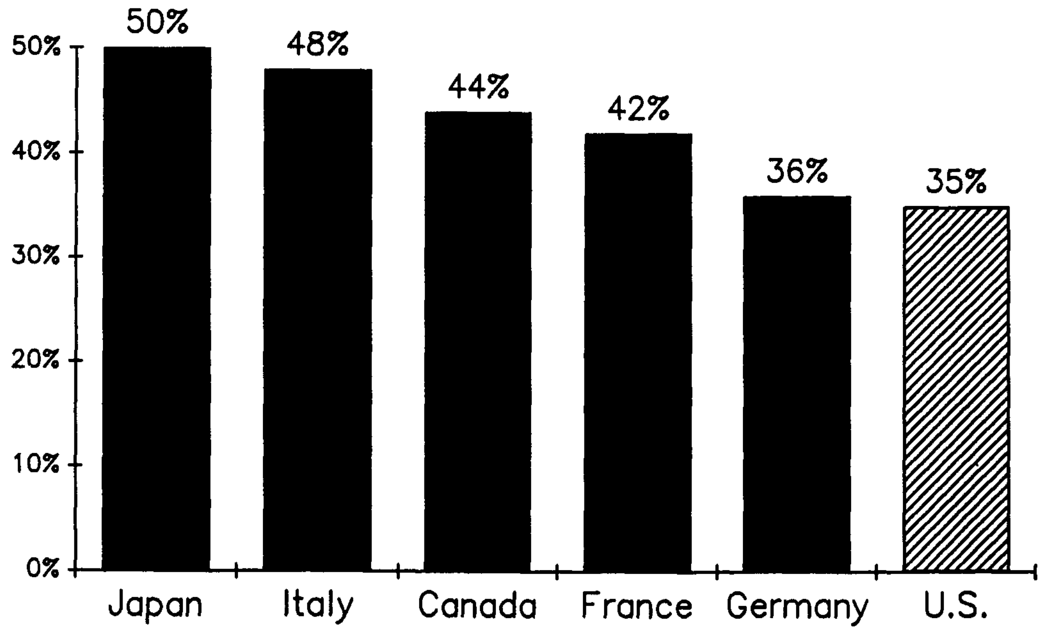
With regard to the family tax credit, the AFL-CIO would favor tax relief for working people and their families if it were paid for by making the tax code more progressive, and by closing tax loopholes such as the foreign tax credit, rather than by unspecified spending cuts that could be harmful to workers' well being. Furthermore, a tax cut that triggers the Federal Reserve to raise interest rates could make workers worse off. Tax relief, moreover, should not be provided to those who have incomes of $200,000 per year!

More fundamentally, the tax provisions of the Contract will not alleviate, and will most likely worsen, the deep seated economic insecurity of American workers. They will do nothing to create more good jobs, reverse the fifteen year decline in real earnings, or assist workers who become unemployed.

The AFL-CIO has views on the other Contract provisions that are within the purview of this Committee, including welfare reform and tax proposals in the Contract that have not been addressed explicitly in this testimony. We look forward to presenting these additional views at a later time.

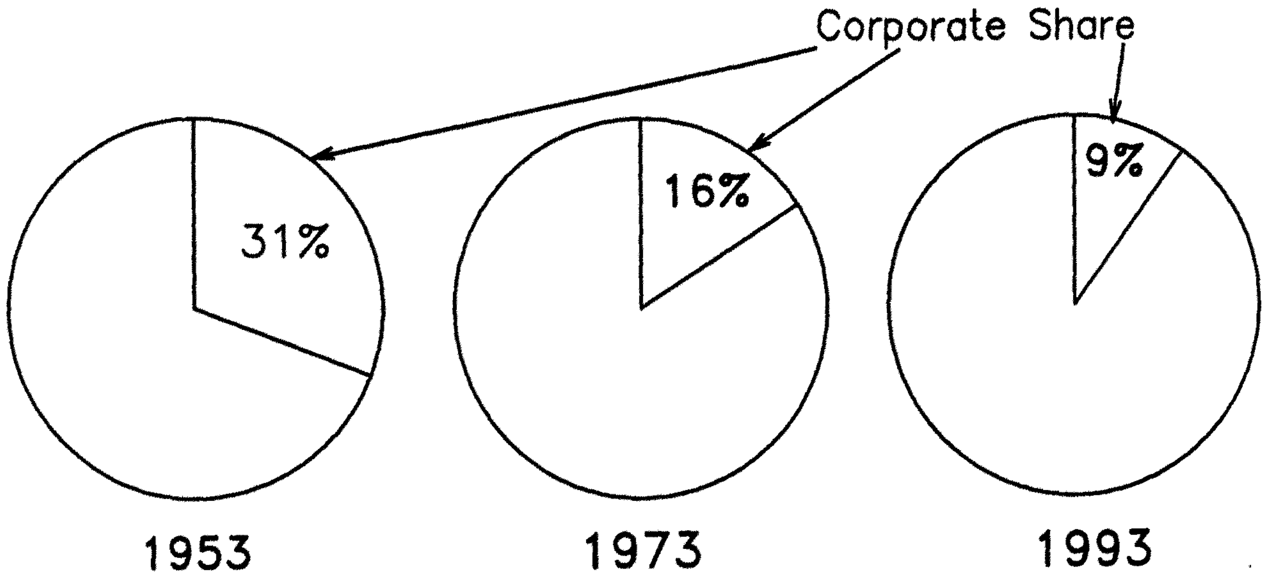
Thank you again for this opportunity to testify.

Corporate Tax Rates in Selected Industrialized Countries



Source: Organization for Cooperation and Development, Price Waterhouse, and National Bureau of Economic Research

Declining Share of Federal Revenues From the Corporate Income Tax



Source: Committee on Ways and Means, U.S. House of Representatives

Appendix 3

AFL-CIO FACT SHEET

TAX EXPENDITURES WHICH SHOULD BE PHASED OUT TO INCREASE TAX FAIRNESS, SAVE JOBS AND RAISE REVENUES

1. **Change the Foreign Tax Credit to a Deduction**

   U.S.-based multinationals are able to take a credit against their U.S. corporate income tax obligations for income taxes that they pay to foreign countries. This provides them with an incentive to invest abroad rather than in the U.S., costing the Treasury and shifting production and jobs overseas. The latest IRS estimates show that U.S.-based multinationals took nearly $25 billion in foreign tax credits in 1990. If the credit was treated as a deduction (as are corporate taxes paid to U.S. states) the Treasury would have raised an additional $16.5 billion.

   REVENUE GAIN = $16.5 billion (1 year AFL-CIO estimate)

2. **Eliminate Deferral of Income from Controlled Foreign Corporations**

   U.S.-based multinational corporations do not have to pay taxes on all of the profits earned by their operations in other countries. Instead they are often allowed to defer these taxes until the profits are "repatriated," meaning returned to the U.S. This encourages these companies to reinvest abroad and costs the Treasury. The 1994 Federal budget estimates that deferral costs $1.6 billion per year.

   REVENUE GAIN = $8 BILLION (5 year AFL-CIO estimate)

3. **Crack Down on Transfer Pricing Abuse by Multinational Corporations**

   During the 1992 campaign, President Clinton estimated that $13 billion per year could be raised by making foreign multinational corporations pay their fair share of taxes. Both U.S. and foreign-based multinationals are able to avoid taxes by shifting their costs of production on paper. For example, a firm can overcharge itself for an item produced by one of its subsidiaries in a low tax country. That shifts its income out of the U.S. and into the low tax location. A simple way to end this practice would be to adopt a formula approach, similar to that used by many states, for computing how income earned by multinationals should be allocated among nations. Professors John Zdanowicz and Simon Pak of Florida International University have developed a sophisticated method for estimating the extent of lost tax revenue due to such transfer price manipulations. Their most conservative estimate is that the Treasury lost $28.7 billion due to such transactions in 1992.

4. **Stop Misclassification of Employees as "Independent Contractors"**

   Dishonest employers often misclassify their employees as independent contractors in order to avoid paying for social security, employment taxes, and various benefits. The House Committee on Government Operations has estimated that such abuse of independent contractor status costs about $2 billion per year in lost revenues.

   REVENUE GAIN = $10 BILLION (5 yr. House Government Operations estimate)

5. **Tax All Corporate Income at 35 Percent Rate**

   Corporate income taxes accounted for over 30 percent of Federal Revenues in the early 1950s. Today they pay for less than 10 percent of the U.S. Budget. Other OECD countries rely more on corporate income taxes to raise revenue than they did in past years. Today, only corporations that earn in excess of $10 million pay at the full 35 percent statutory rate. Below that they face marginal rates of 15, 25, and 34 percent, depending on their profit levels. CBO estimates that eliminating the lower bracket and taxing all corporate income at the same rate would raise an additional $1.9 billion in 1995 and $3.7 billion by 1999. Non-corporate small businesses would not be hurt by this provision, because it would not apply to sole proprietorships, partnerships, or subchapter S corporations.

REVENUE GAIN = $16.2 BILLION (5 year CBO estimate)

6. **Amortize a Portion of Advertising Costs**

Corporations that spend huge sums on advertising are able to deduct these amounts as a cost of doing business. But in many ways advertising is less a business cost than an investment in brand recognition. The benefits of this expenditure last many years beyond the year in which they are incurred. When firms invest, such as when they buy new equipment or facilities, they are not allowed to take an immediate deduction for such expenditures. Instead they must amortize the expenditures, and deduct the costs over time at the rate that their capital is presumed to wear out. Because advertising is at least in part like an investment, with benefits lasting for years, it would make sense to require firms to treat part of this expenditure as an investment rather than a deductible expenditure. CBO estimates that requiring 20 percent of advertising costs to be treated as capital expenditures and deducted over a period of four years would raise $3.3 billion in 1995 and $5.9 billion in 1996.

REVENUE GAIN = $18.3 BILLION (5 year CBO estimate)

7. **Limit Mortgage Interest Deduction for Mansions**

To encourage home ownership, the tax code has historically treated investments in a home more favorably than other investments. Such a policy makes sense for most home owners. But it would also make sense to lower the limit on the amount that is eligible for a deduction. Why should the tax code give preference to the purchase of mansions by the well-off? CBO estimates that, if the limit on the amount of principal eligible for a deduction was lowered from $1 million to $300,000, an additional $1.6 billion could be raised in 1995, increasing to $5 billion by 1999.

REVENUE GAIN = $20.6 BILLION (5 year CBO estimate)

8. **Tax Capital Gains at the Same Rate as Ordinary Income**

Taxing capital gains at the same rate as ordinary income would generate additional revenues of about $15 billion per year. Currently the top federal income tax rate on capital gains is 28%, versus 39.6% for ordinary income. This benefits the wealthy overwhelmingly, since most lower and moderate income taxpayers have little if any capital gains. To make matters worse, the gap in rates on ordinary income versus capital gains creates an incentive for wasteful tax shelters, devices used by the wealthy to convert ordinary income into capital gains for no economic purpose other than to reduce their taxes.

9. **Tax Unrealized Capital Gains at Death**

Taxing unrealized capital gains at death would yield revenues of $9.5 billion per year. Gains on assets that a spouse inherits would not be included, nor would gains on assets donated to charity. Safeguards could be included to prevent forced liquidation of assets, such as family farms, to pay taxes.

REVENUE GAIN = $35.2 BILLION (5 year CBO estimate)

Appendix 4

AFL-CIO Reviews the Issues
Report No. 70
December 1993

ENDING FOREIGN TAX LOOPHOLES: AN ISSUE OF JOBS AND TAX FAIRNESS

Working Americans are increasingly concerned by the decline in the number of good jobs that pay good wages. This concern has been motivated by the fact that U.S. trade deficits have ballooned, while investments that could create new production and new jobs have departed for foreign locations.

The debate over the North American Free Trade Agreement has drawn attention to the export of jobs overseas. Economists estimate that 20,000 jobs are lost for every $1 billion increase in the trade deficit.

Two major loopholes in the tax code contribute to this export of U.S. jobs and production. They are the foreign tax credit and the foreign tax deferral privilege. These loopholes are essentially subsidies, paid for by U.S. taxpayers, that encourage U.S. based multinational corporations to invest abroad rather than at home. It is time, in the interest of jobs and tax fairness, to close these loopholes.

The Foreign Tax Credit: An Example

A simple example may best explain how the foreign tax credit scheme works—as the accompanying table illustrates.

Suppose a corporation makes a profit of $100,000 in the state of Iowa and is taxed at the state statutory rate of 10 percent. The corporation may deduct from its gross profits the 10 percent or $10,000 paid to Iowa; the firm's taxable income at the federal level is then $90,000. If the firm pays its federal taxes at the 35 percent rate established under the new federal budget, the result will be $31,500 in federal revenues (35 percent of 90,000). This illustrates what occurs when taxes are treated as a cost of doing business and are deducted, rather than given the preferential treatment of a tax credit.

EXAMPLES OF THE FOREIGN TAX CREDIT (FOR A PROFIT OF $100,000)

Country/State	Foreign/State Tax Rate	Foreign/State Tax Paid	U.S. Federal Tax Paid
U.S. - Iowa	10%	$10,000	$31,500
Ireland	10	10,000	25,000
Spain	35	35,000	0
Japan	50	50,000	0*

*In this case, the hypothetical firm will have excess credits of $15,000, which could be carried back, or forward, or used to offset the taxes due for profits from another country, such as Ireland.

Examples of Corporate Tax Rates in Various Countries	
U.S. Corporate Tax Rate: 35%	
High Tax Countries	Tax Rate
Canada	44%
Japan	50
France	42
Italy	48
Germany	36
Low Tax Countries	Tax Rate
Ireland	10%
Hong Kong	12
Panama	10
Bahamas	0
Bermuda	0
Note: In Practice Rates vary because of various exemptions, tax holidays and the like.	
Sources: Price Waterhouse, Organization for Economic Cooperation and Development, National Bureau of Economic Research	

Now change the scenario and assume that the firm is doing business in Ireland, but is based in the U.S. Again, it is taxed at the rate of 10 percent. The U.S. federal taxes on its $100,000 profit would be $35,000 (35 percent of $100,000) before applying the credit. But, because foreign taxes are credited instead of deducted, the $10,000 paid to Ireland is subtracted from the amount that would be due to the U.S. As a result, the U.S. treasury receives only $25,000 ($35,000 minus $10,000).

Suppose the corporation makes profits of $100,000 in Spain, where the tax rate is 35 percent. In this case it pays $35,000 to the Spanish government and zero dollars to the U.S. treasury when the foreign tax credit is applied.

Finally, examine the case where the corporation is gaining income from business in a country with higher tax rates than the U.S. In Japan, the corporation pays almost 50 percent or $50,000 in income taxes. Applying the $50,000 in foreign tax credits to the before-credit U.S. taxes of $35,000 once again means that the U.S. treasury receives zero revenue. However, that may not be the end of the story. The corporation is able (subject to certain limitations) to apply the excess credits of $15,000 ($50,000 in tax credits from Japan minus $35,000 credited toward U.S. taxes) to taxes due on income from other low tax countries. The corporation can also carry the excess credits back up to two years or forward up to five years to offset taxes on income earned earlier or later.

Understanding Foreign Tax Deferral

The deferral privilege allows U.S. corporations to pay no income taxes on the earnings of their foreign subsidiaries, unless, and until, the profits are returned to the U.S. In a sense, deferral is an interest free loan from U.S. tax payers for firms that wish to expand overseas subsidiaries by keeping their profits abroad. Because it rewards firms for reinvesting profits in other countries, it creates an incentive to invest, and to create jobs, in other countries rather than in the U.S. A U.S.-based firm that invests and reinvests overseas without ever returning the profits to the U.S. becomes completely immune from taxes on its foreign profits.

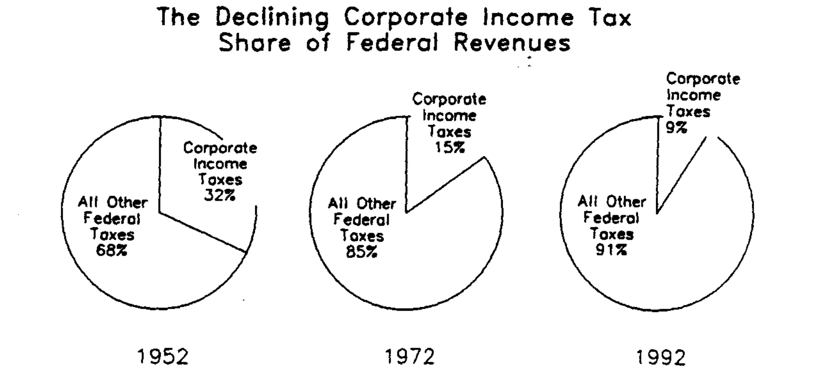
The Two Loopholes in Concert

Together the foreign tax credit and the deferral process provide great benefits to corporations who move production and jobs from the U.S. to other countries. Under deferral, they pay no U.S. federal taxes until they bring their profits home. If they do return profits to the U.S. the foreign tax credit allows them to subtract tax payments made to other countries from their U.S. obligations.

These two tax schemes assume that corporations can avoid U.S. taxes whether they invest in high tax countries or low tax countries. Deferral encourages investment in low tax countries because the corporation pays no U.S. taxes and low foreign taxes until profits are returned to the U.S. The foreign tax credit helps corporations to avoid U.S. taxes, even when they invest in high tax countries. In such cases they pay no U.S. taxes, and get excess credits which often can be used to offset taxes due on profits returned from low tax countries.

Tax Fairness

To American families, whose federal taxes are, for the most part, withheld from their paychecks at an average effective rate of 23 percent, the foreign tax credit and deferral loopholes are astonishing. A 1993 study published by the National Bureau of Economic Research shows that this astonishment is justified. The authors, Rosanne Altshuler and T. Scott Newlon, report that a sample of 340 U.S. parent corporations had foreign-source income of



Source: Committee on Ways and Means, U.S. House of Representatives

$47.3 billion and paid U.S. taxes on that income of only $1.6 billion. (Their figures are for 1986—the latest available when they performed their analysis.) Thus the effective U.S. tax rate on foreign source income was 3.4 percent. In the manufacturing sector, which accounted for 90 percent of the foreign source income, corporations paid only 2.3 percent in taxes.

The AFL-CIO has long supported the basic principle of tax fairness which says that equal incomes should be treated equally. The foreign tax credit and the deferral privilege both violate this principle by granting privileged status to income earned abroad. At a time when both the federal government and the state governments are being squeezed by inadequate revenues, the tax credit amounts to a form of "revenue sharing" between the U.S. treasury and various foreign treasuries. The deferral privilege amounts to an interest free loan from the U.S. Treasury for corporate investments abroad, and in many cases results in outright immunity from U.S. taxes for profits that remain overseas.

Contrast the situation of a firm that operates domestically with that of a firm that invests abroad. A firm that keeps its production in the U.S. and employs American workers pays taxes to state and local governments and pays federal income tax in the year that it makes its profits. It cannot defer its federal taxes to a later year nor can it subtract taxes paid at the state and local level from its federal tax obligations.

A firm that chooses to move production to another country not only injures the workers who lose their jobs, but adds insult to that injury by sending part of the bill to the U.S. taxpayers.

The Drain On The Nation's Revenues

For 1990 (the latest figure available), U.S. based multinational corporations used foreign tax credits to reduce their income tax bills by $25 billion. The AFL-CIO estimates that treating the credit as a deduction would have raised an additional $16.5 billion in federal revenue. The Joint Tax Committee of Congress estimates that ending deferral would increase revenues by another $1 billion.

Surely there are more appropriate ways to spend $17.5 billion dollars other than subsidizing the foreign operations of U.S.-based corporations. The nation has desperate unmet needs in infrastructure investment, education, and health care, to name a few examples.

Answering The Critics

The large corporations and their supporters argue against eliminating the privileged status that income earned abroad now enjoys. They argue that eliminating deferral and the foreign tax credit would place an undue burden on U.S. businesses who are trying to compete in the international marketplace.

These critics of reform are correct that tax subsidies for investment abroad have benefitted multinational corporations and their stockholders. But these benefits have not been shared with the vast majority of Americans who rely on jobs in the U.S. for their income and who pay their taxes.

Complaints that corporations cannot afford to be deprived of these foreign tax loopholes ring hollow when one examines the declining share of U.S. revenues that have come from corporate income taxes over time (see graph).

Critics argue that if foreign taxes were deducted rather than being credited, other governments would "retaliate" by removing foreign tax credits that they offer to their companies that are doing business in the United States. They characterize efforts to change the foreign tax credit as "protectionism."

What these critics are saying is that the U.S. cannot stop subsidizing overseas business, or foreign governments will stop subsidizing foreign subsidiaries operating in the U.S. But there is no obvious reason why any nation should be required to provide subsidies to production occurring beyond its borders.

The foreign tax credit, in effect, turns over the taxing authority of the U.S. government to foreign governments. It says, in a sense, that if a foreign government chooses to tax a corporation, the U.S. will not, and if the foreign government increases the taxes it collects from the corporation, the U.S. will reduce its tax collections in response.

It Is Time For Reform

As a candidate in 1992, President Clinton criticized tax subsidies that encourage the movement of U.S. production to overseas locations. Now is the time for Congress and the President to act, by changing the foreign tax credit to a deduction and abolishing deferral. This would eliminate two incentives that contribute to the export of U.S. jobs and production. It would add to federal revenues. It would move the U.S. system of international taxation closer to the principle of tax fairness.

Removing the privileged status that income earned by U.S. multinationals abroad now enjoys should not be viewed as a protectionist move, or as an unfair effort to raise revenue at the expense of business. Rather, it is a matter of closing a loophole and treating equal incomes equally.

Prepared by Robert E. Lucore
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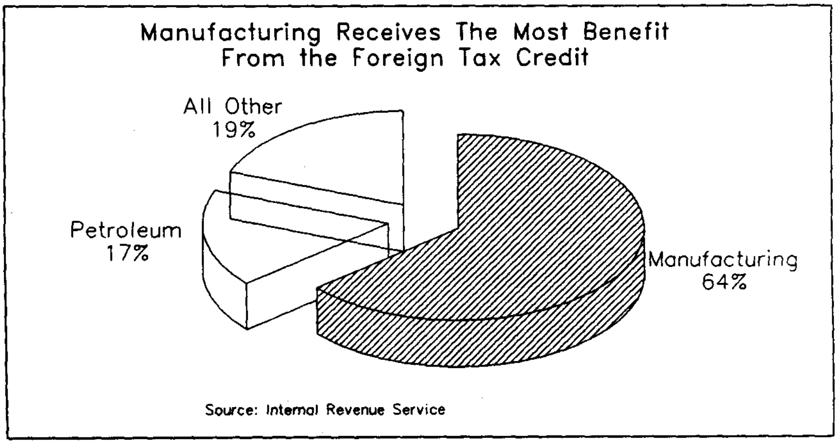

Mr. BUNNING. Mr. Collins will inquire.

Mr. COLLINS. Thank you, Mr. Chairman.

You know, I find it interesting to listen to people talk about estate taxes and the fact that people shouldn't get a break—well, a person who dies is not going to get a break anyway but maybe the estate will. I have heard there are two ways to be a millionaire, to have $1 million or owe $1 million. If a person dies owing $1 million, but yet it is worth $1 million to be able to borrow it, the estate is in trouble. They are going to have to deplete those assets to pay those taxes, and I think that is wrong. I am hoping that we can go farther than this $750,000.

Mr. Huard, you mentioned the alternative minimum tax and I was glad to hear that. Give us some background on alternative minimum tax and exactly why you think that should be repealed. I found with interest the other day that Mr. Gephardt had the same comment when I questioned him about the alternative minimum tax.

Mr. HUARD. Basically, the alternative minimum tax is one of those perverse things that bites you when you are down. They make you recalculate your taxable income using much longer depreciation schedules, less favorable depreciation schedules, and of course, it results in a larger taxable income base.

At times of high profits, or when your business continues to grow, you never have to pay the alternative minimum tax. But when you have a year when you lose money, you could have a regular tax return that says you have got a net operating loss and you are writing checks to the Treasury for the alternative minimum tax, basically, a prepayment of your regular tax that you otherwise owe down the road, but they want it up front. It is, like many things, a bad response to a cosmetic problem.

In the natural business cycle, you have many corporations who have years when they pay tax and years when they pay no tax. And you get various public interest groups who select out the years where they pay no tax and they say, isn't it awful, what can we do about it? And the alternative minimum tax was one of the more stupid responses to that question.

Mr. COLLINS. I agree, I don't like the alternative minimum tax either. I have seen years that you had low profits and you still had to write that check, or even no profits.

Mr. Friedman, you don't seem to have anything, or we don't have anything in our Contract With America that you really approve of, other than the $500 for dependent children for low- or medium-income families. Above that, you have no desire to see the rest of the Contract or any of the Contract approved, I gather from your testimony.

But I oftentimes have heard from people who belong to organized labor, especially when we have trade agreements, that they are very concerned about our businesses moving to different nations, especially those nations who have low-wage rates. But I think one of the greatest competitors to American people and American jobs is the Tax Code. And that is one of the things that we are trying to change, so that we can encourage those businesses and give them a competitive edge to stay here rather than leave this Nation.

And I also find it very interesting that you are opposed to corporations or businesses, large businesses or anyone else making a profit—especially the fact that, as organized labor, you have a contract with employees as well as those employers, and on behalf of those employees you all are always trying to enhance their benefits or their salaries.

So I find it very interesting that you hate to see those corporations or those businesses or those people further their moneys or further their profits so that you can have an opportunity to negotiate on behalf of your membership.

Mr. Motley, would you give us your opinion from the National Federation of Independent Business about the alternative minimum tax? Are you in agreement with Mr. Huard on that?

Mr. MOTLEY. I am completely in agreement with him, no differential at all. If you take a look at our testimony, we are suggesting major simplifications for firms under $10 million a year in gross annual sales, which we think is an arbitrary but decent cutoff between smaller and larger businesses. And one of the things that we suggest is the total elimination of alternative minimum tax for them. I don't see any reason why it shouldn't be done for all businesses and for everyone.

Mr. COLLINS. And you said the average annual income of your membership was $40,000?

Mr. MOTLEY. Yes, Mr. Collins.

Mr. COLLINS. Middle income?

Mr. MOTLEY. It definitely is middle income, although if you take a look at the small business community, what you find out is you have got barbells. You have an awful lot of what you call "lifestyle businesses" where people are working very, very hard. They don't want to grow; maybe the location that they are in, or the town that they are in is not allowing them to grow. They don't have a desire to become a regional or national firm.

Then you have other businesses that want to grow. And therefore, you have barbells, and the barbell on the bottom side is much bigger than the one on the top side. There are a significant number of self-employed individuals who are in business that make substantial amounts of income, but the vast majority of them are down under $50,000 a year.

Mr. BUNNING. Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Chairman.

And I thank this distinguished panel for coming here today.

Mr. Motley, I want to tell you how much I appreciate you being here because of the organization that you represent, the NFIB, I believe the NFIB to be the greatest small business advocate out there. And you have a representative in Omaha, Nebr., by the name of Lee Terry who has worked awfully hard to represent small business and worked hard to continue the ideas that the NFIB stands for.

During your travels and your time, have you got a sense from the small business community as far as our Contract With America? Have you conducted a survey to find out where they stand on the provisions of the Contract, if there is a percentage of various things in it they like better than others? Or have you done that yet?

Mr. MOTLEY. We haven't done anything specific. Of course, as I believe you know, we do poll our members on a continuing basis. And there are over—I think the Contract has 50 individual elements in it, and there are over 20 that we have polled on, and in each case, the members have been in favor generally, by very large percentages, of those 20, even some of the elements of the welfare reform package we have polled on.

But there is also a general sense that the small businesspeople have been extremely frustrated over the last half dozen to dozen years about an increasing level of government regulation and taxes. And they were very angry about it. And our judgment—and I just left an NFIB board meeting over the last couple of days—is that our members are where the Contract is. They support it. They turned out very heavily and they want us to see it enacted.

Mr. CHRISTENSEN. I know that one of the bills that have come before us this week that we are excited about cosponsoring is a national moratorium on new regulations. That is going to give some relief to our small business owners out there.

Ms. Ball, you are with the chamber, besides running your own company. How does the chamber feel about the Contract when it comes to capital gains reduction and looking at other ideas that are going to help out the small business owner?

I also would like to have your comments on the minimum wage and how—there is talk about increasing that minimum wage, when in fact I think that will take away jobs rather than give more money to those people who are on minimum wage.

Ms. BALL. Representative Christensen, I think that the capital gains reduction has been a long beat drum of the U.S. Chamber of Commerce from all sides of its membership, from the smallest members—and I am a small business owner—to some of the largest members. And we have beat this drum long and hard, and now we are hearing an echo that it may come to pass and we are greatly looking forward to it.

In regard to minimum wage, I think if we went back years, several years past and the chamber did some work in regard to minimum wage, and even the New York Times, which I wouldn't call a small owner business newspaper, said that the best minimum wage was a zero minimum wage.

And I think there are things that can best be done rather than raise minimum wage. I think minimum wage really hurts the people on the lower end. And speaking as a business owner and paying my own employees, I think anybody would be very naive if they think that a minimum wage would stop with just the lower end of the business employees. If I gave a $1 an hour increase to somebody that I might have on minimum wage—but I don't have—everybody in my business would expect a $1 an hour increase in minimum wage.

Mr. CHRISTENSEN. Mr. Motley, briefly, could you, in a nutshell, tell me what small businesses' position is on neutral cost recovery and how it differs from, say, large corporations?

Mr. MOTLEY. We would prefer expensing, and there are very, very simple reasons for it. Number one is that expensing is a very simple method of depreciation, where we believe neutral cost recovery is much more complex.

Number two, one of the reasons that neutral cost recovery is in the Contract is that it raises money in the first couple of years. Just for the fact that it raises money there is less money going into the business community and less money going back to smaller firms in cash flow. So we don't believe that it is as friendly as where it proposes to get, and that is expensing.

So, therefore, we would prefer to see if you are going to spend money in the area of increasing incentives for firms to purchase plant and equipment that you move, just as Paul said, in the direction of true expensing rather than an equivalent to expensing.

Mr. CHRISTENSEN. Thank you very much.

Thank you, Mr. Chairman.

Mr. BUNNING. Mrs. Johnson.

Mrs. JOHNSON. Thank you, Mr. Chairman. I, too, am interested in the issue of expensing versus neutral cost recovery.

Mr. Huard, you made the point that many of the big companies, because of the AMT, can't benefit from neutral cost recovery anyway; and it clearly doesn't advantage the small companies, given limited resources. What is the advantage of neutral cost recovery as a component of this package over additional expensing?

Mr. HUARD. Well, the honest answer is, I am not sure there are any advantages. I think—I mentioned in my testimony that we thought it was desirable after you get through with implementing the Contract to look at overhaul—complete structural overhaul of the tax system, and in that context, I think you can achieve across-the-board expensing.

The fact of the matter is, you can't achieve across-the-board expensing in the context of the existing Internal Revenue Code because the revenue cost is prohibitive. So only when you are scrapping the entire current code and starting fresh can you look realistically at expensing for companies of all sizes and for investments of all amounts.

In the context of the Contract, I have to admit you might be better off doing as John suggests and increasing the expensing limit and cutting back or repealing the AMT, and you might have a more potent bang for the buck than you would from NCRS.

Mrs. JOHNSON. Could you help us identify that, what appears to be an increasingly small sliver of businesses that would benefit from neutral cost recovery? Small companies will not, and if companies affected by the AMT will not, you know, exactly what is that group? You can get back to us on this.

What is that group that may and to what extent will they? So——

Mr. HUARD. That requires a little research. We will get back to you.

[The following was subsequently received:]

National Association of Manufacturers

Monica M. McGuire
Director of Taxation
Taxation and Economic Policy

August 16, 1995

Ms. Traci Altman
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Traci:

The following information is submitted on behalf of Paul Huard, Senior Vice President, Policy and Communications, National Association of Manufacturers, as a reply to Representative Nancy Johnson's inquiry made during the January 12, 1995, Ways and Means Committee hearing on selected provisions in the "Contract With America."

The profile of a company which would benefit over time from the Neutral Cost Recovery System (NCRS) proposal would be one that invests in assets with longer recovery periods; however, such a company would have to give up the current law benefit of front-loaded accelerated depreciation. Some NAM member companies expected to benefit from the NCRS have expressed concern that if the NCRS were adopted today, then the benefit to occur only later would be likely eroded or eliminated with changes made by future Congresses looking to save money.

Sincerely,

Monica M. McGuire

Manufacturing Makes America Strong
1331 Pennsylvania Avenue, NW, Suite 1500 - North Tower, Washington, DC 20004-1790 • (202) 637-3076 • Fax:(202) 637-3182

Mrs. JOHNSON. It does. We have talked about increasing expensing for many years in this committee, and we fought hard and we got from $15,000 to $17,500. Big deal. Now we may take the giant step to $25,000. But we have had excellent testimony that $50,000 to $100,000 is really where we ought to be looking, and I think this issue of simplicity and of growth capital is really what ought to be driving our Contract.

I did want to mention, Mr. Motley, that this committee has already publicly committed itself to retroactively reinstating the 25-percent deduction on health premiums, but has certainly not forgotten our strong commitment, as part of health care reform, to moving deductibility up toward 100 percent for self-payers in the way that large companies are able to deduct premiums.

I thank you for your testimony and yield back the balance of my time.

Mr. BUNNING. Ms. Dunn.

Ms. DUNN. Thank you, Mr. Chairman.

I am interested in the estate tax relief that you referred to, Mr. Motley, in your testimony; and I wonder if, for our benefit, you would design for me your perfect approach to estate tax relief beyond doing away with it altogether, which certainly would be a possibility I would hope we would look at at some point.

Could you do that? In which way would it most benefit small business?

Mr. MOTLEY. Thank you for the question. Representing smaller businesses, we looked at the impact that estate taxes have on smaller, closely held firms, farms, and ranches; and they can be devastating, even if the business is only a small portion of the estate where a part of the business has to be sold off by the heir.

Or even more—Mr. Collins, you are in business for yourself and you realize what you have to do in terms of purchasing insurance. That money can be used more productively in the business. It drains the business of a lot of productive capital over the years.

What we are suggesting is that we look at it a little bit differently. Instead of looking at the heirs, you look at the assets of the business and hold the assets of the business, the farm, the ranch harmless to guarantee that it continues so that the jobs that those businesses, farms and ranches provide can continue.

It could be left to a vice president or a foreman; it could be left to anybody else, not necessarily an heir. What we are trying to do is alleviate the negative impact of estate taxes and planning for estate taxes on the business itself.

Only 12 percent of estate tax revenue each year is attributable to closely held business assets. Exempting all closely held business assets in the United States from estate taxes would cost, in our estimate, about $1.2 billion a year. And with some necessary restrictions on the proposal, that number would drop even further, somewhat down under $1 billion.

I think you would relieve a tremendous amount of worry and concern and frustration by the people who have started businesses. You would also relieve a tremendous amount of concern for people who work for those businesses. And it just seems that what we want to do in this country is encourage people to start businesses in their hometowns and localities, provide jobs and provide economic growth; and then all of a sudden, when the person who happened to found it passes away, we take the chance of wiping it out. It doesn't happen all the time. It seems to be counterproductive economic policy.

We are not suggesting exempting all assets from estate taxes, only closely held business assets. Assets in large corporations, which can be publicly traded, are generally no problem; and we are not suggesting eliminating estate taxes for very, very wealthy people whose assets may be in other areas. Just the productive, closely held assets of businesses, farms and ranches, by some estimates in the neighborhood of $800 million or $1.2 billion a year.

Ms. DUNN. Thank you very much.

I would like to also have the point of view of each of you on Dick Armey's flat tax proposal, on how—and this is outside the Contract, but it is something that we will be looking at in the next couple of years—how you would be affected and what your attitude would be toward a flat tax such as that 17 percent supported by Representative Armey.

Mr. MOTLEY. Let me start, and we can move down; and that is to say, I agree completely with Paul, we need to take a look at the basic Tax Code of the country. For small business owners, it is a nightmare. They get in more trouble by not understanding it and having to do their own books than anything else.

Our members when we polled them in a vacuum on flat taxes liked the idea, nearly two-thirds would like to see it done. But in all honesty, we have to take a look at compared to what. What are the other options that are on the table? From a small business standpoint, we would prefer to eliminate both the income tax and the payroll tax and move to something else.

The vast majority of small businesses in this country today pay more in payroll taxes than they pay in all other taxes combined—Federal, State, local, income, sales taxes, everything else. So I think when the committee looks at redoing the tax system, you must also take a look at the payroll tax, and I think that is something that you should move to quickly after this, and hopefully we will all participate in it with you and help you make those decisions.

Ms. DUNN. Thank you.

Ms. BALL. I don't know how the flat tax will finally roll itself out after everybody gets done talking about it, and I think it is really too soon to be speaking about it from my point of view. It is something I think needs looking at, as all tax policy needs looking at is about what I would have to say on it.

Mr. HUARD. Well, the Devil is always in the details, but I am prepared to at least make some fairly warm preliminary comments that it is something that definitely deserves serious inquiry. It would solve a lot of the problems in the existing tax law, particularly in the area of complexity. If you can get a system that significantly lowers the rates from their present levels, then you can seriously talk about doing away with a lot of the special purpose deductions and credits so we don't have to spend our time arguing about corporate welfare and subsidies in the Tax Code. There is a lot of merit to Mr. Armey's approach.

Mr. FRIEDMAN. From what I have seen of Representative Armey's proposal, it would make a bad situation dramatically worse. It is my understanding it would exempt capital income from taxation, it would make a Tax Code which is far less progressive than it should be even less progressive. It would raise less revenues than the current income tax system, thereby causing further elimination of programs. It would put more of an unfair burden on working people and less of a burden on those who can best afford to shoulder the cost of government, which are the wealthy individuals in our society.

Mr. Collins, you, I thought, asked me a question earlier. I don't know if the Chair would indulge me in an opportunity to answer it. I didn't get a chance.

Mr. BUNNING. See, I haven't had a chance to question anybody yet. Can I get a couple of questions in?

Your time has expired, Ms. Dunn.

I would like to ask you, Mr. Friedman, yesterday in his testimony, Les Samuels, the Treasury Assistant Secretary, criticized the Contract's tax provisions as not being sufficiently targeted. That is what he said. Who do you think should be doing the targeting for investment decisions, the Federal Government or individuals and/or businesses?

Mr. FRIEDMAN. Well, I think that, in general, individuals and businesses should make decisions, but they do it based on ground rules that are either set by the market or by public policy. And if you are talking about giving away huge sums, billions of dollars of the public's money—which is really what, for example, capital gains tax preferences would amount to—the public would have some right, it seems to me, to expect particular performance by the recipients of that largesse, even if it was otherwise a good idea, which I am not convinced of.

For example, what would there be in the provisions of the Contract, the tax provisions, that would assure that investments would take place in the United States? If somebody made a profit speculating on peso futures, which might be an area where a lot of profit could be made just now, they would get the benefit of the capital gains tax break on that—as I read the Contract. I don't see what public or social purpose is derived by making such blanket grants of public resources available. Working people can't take a break on their wages; they have to pay taxes on every dollar of their wages.

Mr. BUNNING. I guess we have a different opinion on the public's money. You consider the revenues that we extract from the individual taxpayer as the public's money? Or where do we draw the line on whose money is what?

Mr. FRIEDMAN. If there is a tax rate, if the Congress determines a tax rate on income, whatever it is, it seems to me it ought to apply equally to all sources of income. It is inherently unfair to tax the wages of workers at a higher rate than the investment income or capital gains of wealthy individuals. That is really the point I am trying to make.

Mr. BUNNING. This is a question for the whole panel.

Also in Les Samuels' testimony he said the Contract's tax provision failed the administration test for fairness because they would reduce the progressivity of the income tax. Do you agree that this should be our primary measure of fairness? Aren't there other measures of fairness, like job creation, rewarding work, increased economic opportunity, that we ought to consider at least equally with fairness?

Mr. HUARD. Fairness, Mr. Bunning, is frequently used by its proponents as a pseudonym for income redistribution or achieving equality. The fact is that the Tax Code, as it presently exists, is more than amply progressive. I believe the top 10 percent of the taxpayers pay an astounding amount of tax to the government. I forget what it is, but it is well over 50 percent, so that the Tax Code is already sufficiently progressive.

The idea that we have to penalize success by taking away an ever increasing amount of additional income is what is wrong with the Tax Code, and it is why we are never going to have increased economic growth. The proponents of progressivity and the opponents of things like capital gains tax cuts are dealing with a logical impossibility. They are all warm and enthusiastic supporters of increased investment, increased jobs, but they can't get past the idea that if you provide incentives to do that, it is going to benefit the people that have the money to save and invest.

Ms. BALL. Congressman Bunning, I think I would have to say on all of his statements, and even the ones that you did, a qualified yes.

Mr. BUNNING. Thank you.

Mr. Motley.

Mr. MOTLEY. Congressman, I think fairness is in the eye of the beholder; and I can remember trying to make a case during the last tax increase that we had at the beginning of this administration, when the people within the administration would not want to listen about the unfair nature of the huge tax increases that were imposed upon self-employed businesspeople in this country—virtually the only people who took a huge hit, roughly 60 percent over 4 years. Their taxes went up. FICA went up. Income taxes went up all across the board. So I really do think it is in the eye of the beholder.

You have to do certain things in this country to get people to take risks and when people take risks, generally most other people in the United States benefit from it. So I think you have to balance the two against each other. And I would agree with Ms. Ball and Paul Huard.

Mr. FRIEDMAN. I think fairness or ability to pay is a very important criterion in evaluating any tax system. And if you look at what has happened in our country, the polarization that we have had in the last 15 to 20 years, contrasted with 30 or 40 years before that, where economic growth benefited all segments of our society, that had been the norm.

Since the mid to late seventies we have had the wealthy getting wealthier, and the middle- and low-income levels in our society going downhill; and we have had, for the most part, a tax system which, while it mainly didn't cause that problem, it did compound it. So at the very same time, for other reasons—globalization, technology, whatever it may be—we had the rich getting richer and the poor getting poorer, we had a tax system that was cutting more deeply the taxes for the rich while raising, through the payroll tax in particular, taxes on moderate- and low-income people.

And, you know, the fact of the matter is, fairness does matter. And we have a tax system today which is terribly unfair—unfair to working people, unfair to people of moderate means who work for a living; and I fear that most of the proposals in the Contract in the tax area would take us even further in the wrong direction.

Mr. BUNNING. I will get right to you, Mr. Collins, but I want everyone here to remember that a good Democratic President by the name of Kennedy in the sixties proposed a major reduction in the capital gains tax, and it didn't turn out as it was scored. It turned out to be a net positive for our country. And I think that we ought to remember that it is a bipartisan-type thing rather than a partisan.

Mr. Collins, go ahead with Mr. Friedman.

Mr. COLLINS. Mr. Chairman, I don't believe I asked Mr. Friedman a question. I made a comment, but if he wants to comment back, I would be glad to exchange.

Mr. FRIEDMAN. You made a point, which I agree with quite strongly, maybe for different reasons, which is that you, I believe, stated that the Tax Code is the source of a loss of jobs from the United States today; and I agree very strongly with that point. If you look, for example, at the foreign tax credit, which gives U.S.-based corporations a huge subsidy for exporting U.S. workers' jobs, that ought to be changed; this is something that more detail is provided on in the attachment to our statement.

There are a whole host of provisions in the Tax Code that reward corporations for destroying or exporting jobs. The tax treatment of mergers and acquisitions is one example, which was a contributor to a great deal of job loss in the late eighties, and even still to some degree today. So I agree with that point.

I am certainly not opposed—and I am sorry that I created the impression that I was opposed—to corporations making a profit. The point I was trying to make is, when they do, they ought to be willing to pay a fair share of taxes on those profits. While their profits have been holding up, their taxes have been coming down; and we would like to see corporations pay a fairer share of taxes.

Mr. COLLINS. You know, I am a small businessman and have been for 32 years. I have been contracting with a very large, one of the Fortune 500 companies for 24 of those 32 years. I was always of the mindset that I hated to see that corporation, even though they were a conglomerate and very big compared to me, I hated to see them spend any money that was unnecessary, whether it be in taxation or whether it be in the operation of their business. I always felt like every nickel that they spent that was unnecessary was a nickel that I couldn't earn. And I feel that same way toward your membership, that every nickel that a corporation spends is a nickel less that your membership has an opportunity to bargain for.

But also there are a lot of hidden taxes in this country. Corporations and businesses really don't pay tax. They collect those taxes through consumer goods or services that they render. And after the 1993 tax bill was passed here, I went back to my district and I explained it somewhat like this: The next time you walk in the grocery store, you stop at the front door and you look across that store and you will see shelf after shelf filled with items—many, many different brands, many, many types of items, thousands of items. First of all, those items didn't grow there. They were transported there.

And we had just increased the fuel tax, a fuel tax that is going to be reflected in the price of every one of those items.

And if you go down through there and look at the names on every brand that is there, you will find some of those big conglomerates that we just penalized with additional taxation. That additional taxation is, too, going to be built into the price of that item. Your membership, my constituency, they are going to pay those hidden taxes when they pick those items up.

Businesses don't pay tax, they collect it from men and women who work, who draw an income, and spend that income on behalf of their families and for existence.

I enjoyed the exchange. Thanks for coming. Thank you, each of you, for being here.

Mr. BUNNING. Thank you. I want everybody here to know how deeply we appreciate your testimony. We all know that—we asked you to talk about the Contract With America. And you all know that we have a big job in the first 100 days, but that does not mean that this committee will not look into the overall Tax Code after the first 100 days, and you can bet your life, we are looking forward to it.

Thank you very much for your testimony.

[Whereupon, at 3:42 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

TESTIMONY OF
CONGRESSMAN CHRISTOPHER SHAYS

BEFORE THE
HOUSE WAYS AND MEANS COMMITTEE

Chairman Archer, Congressman Gibbons, and members of the Committee, thank you for providing me the opportunity to testify before your committee to discuss the five bills within the Contract With America that are under the committee's jurisdiction. This is an important part of moving the contract forward. I would like to take this opportunity to share my views with you on these five proposals.

I. THE AMERICAN DREAM RESTORATION ACT

H.R. 6, the American Dream Restoration Act, of which I am a cosponsor, will help restore economic viability to the American family, and promote greater individual savings.

As you know, the bill provides a tax credit of up to $500 per child for families with incomes under $250,000. Phase out of the credit would begin at $200,000, with full phase out at $250,000.

The legislation also provides tax credits to individual affected by the marriage penalty, which occurs when a married couple pays more as a couple than they would as individuals.

Finally, the legislation creates a new type of Individual Retirement Account (IRA) which would permit individuals with any income level to contribute up to $2,000 per year ($4,000 for married couples) into a new IRA, called the American Dream Savings Account (ADSA). These new accounts differ from conventional IRAs in that individuals would pay income tax on contributions to the accounts, but would be able to make withdrawals tax free. Current IRA participants would be allowed a two-year window to roll over existing IRAs into an ADSA.

I strongly support these provisions. As you may know, the Republican Budget Alternative for fiscal year 1995 (FY 95), written by the Republicans on the Budget Committee, included provisions providing for expanded IRAs and a $500 tax credit per child. Our alternative budget not only provided for greater deficit reduction in FY 95 than the President's budget but also paid for the tax incentives. It is equally important that the tax provisions in H.R. 6 and all the tax provisions within the Contract With America be paid for. Tax provisions will not help if ultimately they contribute to the federal budget deficits.

II. THE JOB CREATION AND WAGE ENHANCEMENT ACT

H.R. 9 is an effort to do just what its title states -- help create jobs and enhance the wages of American workers.

Small business continues to be the job creator in our economy, but federal taxes and regulations have stifled small business creation. While the United States and the Soviet Union were fighting the Cold War, our trading partners in Europe and Asia have been fighting an economic war. It is essential that we provide ways to help businesses advance in the global market. This bill is an effort to create a better environment for growth in what has become a very competitive global economy.

I support the tax provisions in H.R. 9, which include: cutting the capital gains tax; increasing capital investment depreciation; raising the estate tax exemption; providing greater expensing on equipment for small businesses; and restoring the deduction for individuals who work out of their homes.

One of the ways we can help businesses is by reducing the burden of taxes. As you know, the bill provides a 50 percent capital gains tax rate cut and prospectively indexes capital gains to account for inflation. It will reduce the current tax rate from 39.6 percent to 19.8 percent. It also allows those who lose money on the sale of their home the ability to deduct the loss from their taxable income.

The neutral cost recovery system allows businesses to depreciate the original cost over the life of the equipment, plus inflation, plus 3.5 percent each year. This provides the opportunity for businesses to deduct the true value of this investment by factoring in the effect of inflation.

Accordingly, businesses that invest less than $200,000 in depreciable property each year will be able to receive an immediate $25,000 deduction on the purchase of new equipment, which represents an increase of $7,500.

Also included in the bill is an increase in the exemption of the estate tax from $600,000 to $750,000. The increase in the exemption is phased in beginning at $700,000 in 1996 and increasing $25,000 over the next two years.

H.R. 9 also clarifies current regulations concerning the deduction of home office expenses by allowing those who perform essential administrative and managerial duties of the business in their homes to take these costs as a business deduction.

Under the Taxpayer Debt Buy-down provision, taxpayers could designate up to 10 percent of their taxes to reduce the federal debt. Congress would be required to reduce government spending by the amount in the Public Debt Reduction Fund or mandatory sequestration would take effect. The Congressional Budget Office (CBO) has calculated that if all taxpayers checked off the maximum level of 10 percent, and Congress was then forced to make the reductions in spending necessary to comply, the federal budget deficits would be eliminated by the year 2000. While I cosponsored the Taxpayer Debt By-down last Congress when it was introduced as a separate bill by Congressman Bob Walker of Pennsylvania, I believe this provision of H.R. 9 should not be included if the balanced budget amendment is ultimately ratified.

The Taxpayers Debt Buy-down provision is a tool to force Congress to reduce our annual federal budget deficits, but in my opinion, the constitutional amendment is a far stronger tool. I believe it might be ultimately harmful to our economy if both the Taxpayer Debt Buy-down and the balanced budget amendment were in place.

While I support many of the provisions in this bill, I have concerns with Title IX: Private Property Rights Protections and Compensation. As you know, under this provision private property owners would be compensated by the Federal Government if the use of their property is limited as a result of actions taken by the Federal Government.

I agree private property owners should be protected from undue financial harm caused by an overzealous federal government. But the Fifth Amendment of the Constitution provides this protection and the courts have, in most cases, been an appropriate forum to address these issues.

Title IX raises several questions that I would like to share with you. One question I have is related to retroactivity. I am unclear as to whether people would be able to receive compensation for property depreciation as a result of a regulation that is already in place. If this is the case, it seems the bill would open up the possibility for people to apply for compensation above and beyond what was paid for the property.

It is also unclear whether H.R. 9 would apply to potential loss of property value, or just actual loss. For example, suppose an individual planned to build an apartment complex on a piece of property, but then found out that an endangered species lived on the land. It is not clear to me if property owners would be compensated for the potential increased revenue that might have been gained had the apartment complex been built. It seems it would be difficult to determine the amount of compensation due a property owner under this type of scenario.

Another issue raised by the bill's provisions is that of direct versus indirect loss of property value. Most property value is in some way linked to other nearby property. If a wetlands regulation meant that an amusement park couldn't be built in a particular community, I am unclear whether a neighboring property owner could receive compensation because his plans to develop the land based on the development of the neighboring amusement park were no longer economically viable.

I recognize that regulations sometimes result in decreased property value, but they also can result in increased property value. The federal government does not expect to be compensated for such "givings," and it seems to me this understanding should be a part of the debate on "takings."

Clearly, compensation under this bill could be extraordinarily expensive. By requiring agencies to use their own appropriations to fund the compensation, the intent seems to encourage agencies to loosen regulations. But we, as lawmakers, must hold ourselves accountable for making good laws that make sense. If we feel a law does not make sense, we should change it.

Finally, I wish to express my concern about how this law might affect our environment. Our nation's environmental laws and regulations were created to protect the health, lives and safety of American citizens. In addition, they aim to preserve and protect our natural resources for future generations to use and enjoy. This lofty goal should not be taken lightly and we must take responsibility for achieving and maintaining it. Environmental laws and regulations need to be debated, and at the end of that debate some laws might need to be strengthened, and others weakened. But they should be assessed based on the merits, and not on the broad ramifications that could result if Title IX of H.R. 9 became law.

My staff and I have spoken with many people and organizations who have brought up these and other questions regarding possible scenarios under which people could be compensated under Title IX.

These concerns, among others, lead me to believe that the issue of federal takings is best left up to the courts. Every claim will be different, and should be decided on a case-by-case basis, not on a sweeping law open to wide interpretation.

If we decide that Congress, not the courts, is that best forum for deciding the issue of "takings," I hope some changes will be made to the pending legislation. I support raising the percentage of property loss meriting compensation. In addition, I hope that any "takings" legislation passed by Congress is more narrow in scope, so the ambiguities such as the ones I have outlined are made clear.

III. THE FAMILY REINFORCEMENT ACT

I would also like to thank you for allowing me to testify on H.R. 11, I am proud to be a cosponsor of this important legislation.

The Family Reinforcement Act, of which I am a cosponsor, offers tax relief for an already overburdened middle class by providing credits in two areas which have previously been overlooked. The $500 per person eldercare credit will give needed assistance to families who are caring for the elderly, and the $5,000 credit for adoption expenses will help find new homes for displaced children.

Another area which needs strengthening is child support enforcement. H.R. 11 includes provisions that help prevent non-custodial parents from turning their backs on their children. Given the fact that child support payments often determine whether a family remains financially stable or is reduced to poverty, it is imperative our government actively and vigorously enforce child support regulations.

A third provision of the Family Reinforcement Act which I believe is extremely important is the increase in sentences for sexual offenses against children. I am glad the bill also provides for a minimum three year sentence for anyone who forces children into prostitution, a provision I strongly support. It is about time criminals who commit such horrific acts on our children begin to pay for their crimes.

It is my hope the passage of H.R. 11 will be a major step in ensuring that the interests and needs of our children are protected. This bill will offer a better, brighter future for the families of our great nation.

IV. THE SENIOR CITIZENS EQUITY ACT

I would like to express my support for the provisions of the Senior Citizens' Equity Act which would raise the earnings limitation on older Americans, and commend the Ways and Means Committee for acting so promptly in the 104th Congress to correct this injustice.

I believe Social Security recipients who want to continue working should be able to earn outside income without being penalized. Senior citizens, like any other group of Americans, have a right to work to achieve financial independence without being penalized by the federal government.

Unfortunately, that is not currently the case. The earnings test imposed on senior citizens, taxing their Social Security benefits if they earn more than a certain amount, is an unfair punishment for those who wish to stay productive and contribute to our economy.

Persons aged 65 to 69 can receive full benefits as long as they earn no more than $11,160 in outside income. Benefits under this category are reduced $1 for every $3 earned above this amount. For those citizens 70 years old or older there is no earnings test.

The Senior Citizens Fairness Act, of which I am a cosponsor, would phase in an increase of the earnings limit over five years, raising it to $15,000 in 1996, $19,000 in 1997, $23,000 in 1998, $27,000 in 1999 and $30,000 in 2000.

Support for this change is strong, both from the public and here in Congress. We cannot afford to ignore the experience and professionalism older Americans bring to our workforce. In addition, these older Americans will be working longer and paying more taxes.

The earnings test, developed during a depressed economic environment, was designed to drive workers out of scarce jobs. Its repeal is long past due as a recognition of the changing needs of businesses struggling to find qualified workers and remain competitive.

V. THE PERSONAL RESPONSIBILITY ACT

As this committee knows all too well, many welfare recipients view employment as a threat to their standard of living. We have created a culture of dependency where getting a job may actually result in a decreased income. This must end. We must change the welfare state so that people are encouraged to work and save in an effort to become self-sufficient.

In a perfect world, certain provisions of H.R. 4, the Personal Responsibility Act, could be seen as outdated, but unfortunately we do not live in a perfect world. When you have 12 year-olds having babies, 14 year-olds selling drugs, 15 year-olds killing each other, 18 year-olds who can't even read their own diplomas, and 30 year olds who have never held a job, you see that measures such as orphanages and foster homes must be considered as possible solutions in reforming the existing welfare system.

We also need to encourage our young people to focus on moral living. Government legislates immorality when it encourages our children to have babies out of wedlock rather than in wedlock and doesn't hold the fathers accountable.

H.R. 4 contains provisions, which I support, that reform our welfare system and provide greater control to the states in the use of federal welfare funds.

The legislation will terminate Aid to Families with Dependent Children (AFDC) payments to unwed mothers under age 18 and their children, while allowing the states to have the option to extend payments between the ages of 18-20. The savings from these programs will then be given to the states in the form of block grants. These block grants may be used to establish orphanages or group homes for unwed mothers. Also H.R. 4 requires paternity to be established to receive full benefits.

The Personal Responsibility Act also will eliminate welfare benefits to legal permanent residents. I support placing this limitation on federal assistance programs because it will preserve the original intent of social service programs -- to protect citizens of our country -- and discourage immigrants who come to the United States intending to apply for benefits.

There is one element of H.R. 4, however, that gravely concerns me. I am opposed to any provision that would silence health professionals from advising their clients about abortion services. I believe the government has no business interfering in the relationship between a doctor and their patient. The "gag rule" denies all women, especially those less fortunate, information about the full range of available medical options. This could cause them to make uninformed decisions and deprive them of needed medical services. I have always voted against the "gag rule provision" and will do so again should this language remain in H.R. 4.

A fifth provision of the Personal Responsibility Act is the consolidation of 10 nutrition programs such as food stamps, Supplemental Nutrition for Women, Infants and Children (WIC), and the school lunch and breakfast program into 1 block grant. I support this idea because I believe each state and town should be able to decide where it can best use the money. For some it may be in the schools, while others may desire to utilize the moneys to strengthen the food stamp program. I also believe competition is important and only those programs which truly need the funding will receive them under this proposal.

Thank you for your consideration of this testimony.

STATEMENT OF HON. LOUISE M. SLAUGHTER
A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to be here today to testify on what is shaping up to be the Agenda for the 104th Congress. I am pleased that the Committee will be hearing from both Democrats and Republicans on the "Contract with America."

I have closely studied the Republican "Contract with America," and I have serious concerns about the short and long-term implications of this framework. While I do not deny that there are several appealing aspects of the proposal, I must challenge you to ensure that we do not jeopardize our long term financial stability.

We have heard a great deal about the "Family Agenda," and I have consistently supported policies and programs aimed at helping working families who are struggling to raise children and plan for their future. We must continue this effort in the future, and not turn our backs on our children and grandchildren. One key area in which we can dramatically affect our children's economic future is by further reducing the federal deficit. Congress and this Administration have worked hard to bring spending down and lower the deficit. We must not abandon this effort. For the past three years, the deficit has declined; it is estimated that the deficit for fiscal year 1995 will be significantly lower than original projections. As a percentage of GDP, the deficit has been cut in half in less than four years. This was not an easy task and we all made some tough decisions. But, if we have learned nothing, we have learned that fiscal responsibility and discipline is critical.

As I look at this Contract with America, I am deeply troubled by conservative estimates of cost. I have seen reports that claim that all the provisions of the contract will add another $1.4 trillion dollars to our debt. This is staggering. Can this amount be off-set with cuts? Can we protect the integrity of Congressional scorekeeping? Can we guarantee that the actions we take now will not force future generations into bankruptcy? All of these questions must be addressed, and we need solid projections and specific answers. Unfortunately, for some of the provisions of the Contract, there are no simple methods available for determining costs.

Take unfunded mandates; if we act to delay or eliminate key mandates in the Clean Air Act, for example, what will be the financial implications and how will we score these costs? The unhealthy carbon dioxide level in the air in our major cities contributes significantly to the cost of health care and declining productivity of urban residents. Will these increased costs be included in our deficit calculations? Additional respiratory illnesses for senior citizens will increase the cost of Medicare. Will we factor this into the equation?

I have always been a strong supporter of government incentives for business, as is illustrated by my authorship of legislation (which became law in August 1993) to make the tax exemption of industrial development bonds (IDBs) permanent. And I am extremely interested in the capital gains tax reduction, called for in the Contract. However, it should be noted that the Joint Tax Committee has estimated that a 50% reduction in capital gains tax could ultimately cost tax payers $56 billion. I realize that there is an effort to change the way we determine the budgetary impact of tax cuts, but we must be careful to avoid budgetary gimmickry. We can change the calculations, but we will still face deficit problems.

As a result of OBRA 1993 and serious budget discipline, our economy has improved. More jobs have been created and investments are improving. Drastic reductions in federal spending, including the mandated 272,000 reduction in the federal work force, have contributed to the strengthening of the economy. I support the argument that American families and senior citizens should be the first to see benefits from this reduction in government. But we still have an obligation to pay for any tax cuts. I am willing to continue to support tough deficit reduction. In fact, at this very moment I can suggest at least $30 Billion in spending cuts. These include a $1 billion reduction in the Intelligence budget; $24 billion from slowing the development of the F-22 fighter to meet actual need; cancelling funding for the two Milstar II satellites which would provide a long-term savings of $2 billion; and cancelling the Space Station, with a long-term savings of close to $50 billion. I would be happy to share with the members of the Committee additional recommendations.

But I must caution the committee that I will not support major cuts in investment spending -- for effective and necessary programs in education, Women and Infant Children nutrition, Head Start, and health care research. Nor will I ask senior citizens who depend on Social Security, Medicare , Veterans benefits, and nutritional assistance to bear the brunt of the sacrifices we intend.

Neither can we afford to mislead the working families we represent. We must be honest and tell them that they will be hurt, rather than helped by a $500 tax cut, if the cost of education and health care increases by $1,000 to $1,500 a year. And it would seriously hurt the health status of American women if we were to enact across-the-board cuts in federally funded medical research. This is not the time for cutbacks on research, with the incidence of breast cancer on the rise and with progress being made on so many fronts.

As one who has worked in this House for years to ensure that research into diseases affecting women gets its full share of federal research funds, I will not stand by and watch our small advances be destroyed. 46,000 women will die from breast cancer this year; the federal government must not back out of its commitment to improve treatment and prevention for this and so many other deadly and disabling diseases.

I pledge my support for maintaining budget discipline and hope to work with you in moving forward, building on the progress we have already made.

STATEMENT OF
THE SMALL BUSINESS COUNCIL OF AMERICA, INC.

BEFORE THE COMMITTEE ON WAYS AND MEANS
OF THE UNITED STATES HOUSE OF REPRESENTATIVES

ON
TAX AND REGULATORY STRUCTURE TO MAXIMIZE ECONOMIC GROWTH AND DEVELOPMENT
February 2, 1995

SBCA is a national nonprofit organization which represents the interests of privately-held and family-owned businesses on federal tax, health care and employee benefit matters. The SBCA, through its members, represents well over 20,000 enterprises in retail, manufacturing and service industries, which enterprises represent or sponsor over two hundred thousand qualified retirement and welfare plans, and employ over 1,500,000 employees.

It is time to focus on simplifying the tax and regulatory structure that is strangling economic growth and opportunity. We believe your Committee and Congress should have a special interest in focusing on the need to create a tax system geared to maximizing economic growth, business development, and self-sufficiency.

THE CONTRACT WITH AMERICA

The SBCA supports most, but not all, of the Contract with America, and other simplifying issues. We support:

1. Increasing the estate and gift tax exemption from $600,000 to at least $750,000. This limit should also thereafter be indexed for inflation. This will assist in preserving business, including the family farms, by reducing the need to sell them to pay estate taxes.

2. Expanding the Individual Retirement Account, creating a new American Dream Savings Account (ADSA). The ADSA is "back-loaded" --- meaning taxes are paid on amounts deposited, but not on amounts withdrawn for qualified purposes. Amounts escape taxation if withdrawn for: (1) retirement income, (2) purchase of first home, (3) college tuition, or (4) medical expenses.

3. Correcting the "marriage penalty", which presently taxes married couples at a higher rate than unmarried couples. For example, married couples are penalized by a standard deduction which is $3,900 for singles, but only $6,550 on a joint return. They're also hit by higher rates. Two singles with income of $50,000 each are in a 28 percent tax bracket. A married couple with $100,000 is in the 31 percent bracket.

4. Creating tax-exempt "Medisave" accounts through which the uninsured could pay for health insurance and medical care.

As to health policy, SBCA supports 5 goals and several specific actions:

1. Universal Private Insurance Access

2. Incentives for Private, not Public, Buying Alliances

3. Medi-Save Accounts and Tax Incentives

4. No Employer or Employee Mandates

5. No Global Budgets or Price Controls

SBCA's PLAN:

A. A Moratorium on Piecemeal Reform

B. Private, Not Public, Management

C. Preservation of Small Business Incentives

D. Clear Antitrust Guidelines and Employee Tax

E. No Price Freezes that Cause Shortages

F. A "Sunshine Law" for Health Care Data

G. National Awareness and Education

H. Preservation of Out-Of-Panel Physician Choice

We believe that Congress should convene its own blue-ribbon panel to work out an incremental health care policy which will provide a safety net for those who cannot afford coverage, but not bankrupt the small businesses in our Country. This blue-ribbon commission should include the experts involved in the health care industry.

5. Creating a tax credit of $500 per child for families with earnings under $200,000. However, we would not favor those between $200,00 and $250,000 getting a reduced amount.

6. Excluding 50 percent of longterm capital gains from tax, and index the basis of most capital gain assets for inflation.

7. Clarifying, and liberalizing the home office deduction. Start up companies and individuals, especially those with small children, should be allowed to have the same office deductions for

home offices as other offices.

8. We support an increase in allowable business write-offs for new equipment. Contract With America would increase the current $17,500 write-off to $25,000.

9. Simplifying our tax system by eliminating special definitions for special types of organizations or industries to provide flexibility for businesses and their accountants. Specifically eliminate all definitions of "personal service corporation" except as required by the accounting rules of Code Section 448. Eliminate the other six different definitions of "personal service corporations" contained in 10 Code sections as follows: 441(i) , 444, 11(b) , 269A, 414(m) (3) , 535(c) (2) (B) , 469(j)(2), and 263A(h)(3)(D). This will eliminate the silly and burdensome requirement of forcing most of these entities on calendar years, which is detrimental to clients and their accountants, and will eliminate treating architects, engineers, physicians, veterinarians, etc. differently from other types of business entities.

10. Allowing employee stock ownership plans to be established by subchapter S corporations. Presently they are not allowed because the employee stock ownership plan is not a "qualifying shareholder" under Internal Revenue Code Sections 1361, et seq.

11. Simplifying our pension and ERISA system and begin to deal honestly with the overburdening deficits that are robbing our children and grandchildren of their futures. More detail on this issue, which we believe is the most important, is enclosed hereafter.

ENTITLEMENTS, THE DEFICIT, AND A SECURE FUTURE

We do not support reducing taxes on Social Security, however, as proposed by the Contract. Social Security taxes mask the true nature of the deficit and are already making it very hard for "boomers"and "Generation X" to save for retirement. Social Security also needs funding help to remain viable financially.

1. **Entitlement Growth** - The Bipartisan Commission on Entitlement and Tax Reform, appointed by President Clinton, and headed by Senators Bob Kerrey (D-Neb) and John Danforth (R-Mo) issued its report in December 1994. Our country has major problems to which Congress must immediately turn its attention:

- **Entitlements will soon be 70% of our federal budget.** In 1963 we spent 71% of every federal dollar for education, technology, roads, bridges, defense and other productive programs. Now we are looking at spending that much in the year 2000 on interest on the federal debt and entitlements alone. Something has got to change!

The six largest entitlements are as follows:

Federal programs	Projected cost in 1994
Social Security	$317 billion
Medicare	158 billion
Medicaid	84 billion
Other Retirement/Disability	72 billion
Unemployment Compensation	27 billion
Food Stamps	26 billion

2. The Role of the Unfunded Public Pension Plans.

Private pension contributions have been restricted and discouraged by Congress in the 1980s because of its voracious need for more tax revenue. The potential unfunded liability, if all companies in the USA were to quit funding their plans, would be **38 billion dollars.**

But the unfunded liability benefits promised for **federal pensions as of the last available statistics, was over 1.1 trillion dollars -- nearly forty times the 38 billion of the private sector.** These pensions are not funded.

Just like Social Security, the federal government pays as it goes. There is no separate trust fund set aside for federal pensions. They are funded by promises and can only be paid by our taxes on a "pay as you go" basis. The largest components of the unfunded federal pension deficit are as follows:

Military Retirement System Civil Service Retirement System Federal Employees Retirement

Military Retirement System	513 billion
Civil Service Retirement System	600 billion
Federal Employees Retirement	5 billion
Total	$1.1 trillion

The federal unfunded liability is not potential, as in the private sector, but actual.

In addition, public employees have a pension indexed for inflation, with cost of living adjustments ("COLAS"). Thus, with the leveraging of fact of higher pay, plus more generous formulas, which are index for inflation, the average public employee is in much better shape than the average private employee. In addition, they have a lower retirement age (55) than many private pensions.

3. The Federal Deficit -- Recent Events have Lulled Us

Into a False Sense of Security. The Congressional Budget Office projections show the deficit hitting a seven year low of 166 billion in fiscal year 1996. However, its CBO estimates show a deficit growing quickly and reaching a record high of $324 billion by the year 2003. Remember, the aggregate national deficit has increased from $.5 trillion in the late 1970s to $3 trillion today, and could be $6 trillion by the year 2000.

4. **The Real Federal Deficit**. If the federal government had to account for pensions the same way it requires private business to do, the formal U.S. debt would increase 32% from $4.7 trillion to $6.2 trillion. Social Security funds are loaned to the U.S. and mask another $60 billion or so in the deficit.

Entitlements need to be reduced, so as to stop robbing our children and grandchildren. Our retirement system, ERISA, needs to be repaired and restored to its former health.

We have had change after change, which has really been more and more taxes in the guise of fairness. It isn't just budget balancing. This is budget balancing in the guise of improving the system. In the late '80s and the 1990s, those years showed that nothing based on tax incentives will ever work well within an unmanageable deficit and ERISA was no exception, particularly without strong and knowledgeable backers in the legislative and executive branches or elsewhere. The pension system when under budget pressure has begun to collapse.

The other bad thing that's happened in the post-1974 years when ERISA was ended has been Congressional staff takeover in the wake of over-complexity. ERISA was not a simple bill, but it was understood when it passed in 1974. Since then, Title I of ERISA and its corollary sections in the Internal Revenue Code have become so complex that hardly anybody understands it. The result has been an abdication by members of their true legislative duty in favor of staff control. The result is an irresistible engine of complexity compounding itself to the detriment of retirement income security.

In the 1980s and '90s, therefore, we have ERISA amendment after amendment purporting to make the system fairer when in fact these amendments simply make the system less attractive to plan sponsors, thereby deterring plan establishment and growth, thereby increasing taxes, which is what these amendments are really about.

In other words, many of the things that have been done have occurred in the name of non-discrimination. If you're against them, you're for discrimination. Well, that simply is not true. The change in the IRC Section 415 limits, from $45,000 in 1982 to $30,000 in 1984, the change in the total compensation that can be taken into consideration ($200,000 for "top-heavy" plans in 1984 and then again $150,000 in 1993, despite inflation), a whole host of these changes have been detrimental to participants as well as plan sponsors and administrators.

But the complexity of ERISA and the Tax Code makes it rather difficult to generate the kind of interest that would get the general public or substantial elements speaking out.

Private pension plans cover about half of full-time workers. When you look at that overall coverage more closely you will find that the reason 50 percent are covered at this point is because of the rapid growth of the 401(k) plans. From 1983 to 1993, coverage under the more traditional other types of plans actually decreased from 47 percent to 33 percent.

Why has this erosion occurred? Because pension have been viewed as fair game for meeting revenue needs. It has become a creature of tax policy. Elitist tax economists, and government and IRS bureaucrats, principally Stanley Surrey but also his legion of followers, have succeeded in fixing the pension law with the label "tax expenditure." So this has not only provided the justification for continual retinkering of the rules to implement a host of policies that are constantly changing. This onslaught has left the pension system defenseless against the demands of the constant budget deficits of the past 15 years that have damaged the pension system for no policy purpose whatsoever than the need to raise revenue.

Is it any wonder that we have a pension law today that is largely dysfunctional? In the words of the New York State Bar Pension Simplification Committee, ERISA is now, after all these changes, a hodgepodge of conflicting goals, policies and overburdens. We had a remarkable pension system in this country. It began after World War II and it grew to the presence that it enjoyed until the turnaround that began in the eighties when we got these excessive series of law changes: ERTA, TEFRA, DEFRA, REA, OBRA, TRA86, etc.

The key social goals, funding, vesting and benefit accrual, have been well met under ERISA. But from the perspective of the employers who want to provide good benefits, the question is whether the cost is worth playing the game.

It is entirely possible that the private pension system is going to collapse of its own weight while we're waiting for simplification. Particularly now, where we are in the process of sending plans into the Service, sometimes for the first time since REA, that employers, not the ones who are most actively involved but the ones who do the minimum necessary, are flabbergasted by the amount of information that is required and the number of hoops that they have to jump through to do a simple submission.

The SBCA knows from the experience of its Advisory Boards that most employers really want to provide good benefits, but the cost of compliance both in fees and in employer time can outweigh the benefit. Since ERISA, there have been nearly thirty new laws affecting plans, an average of nearly one every nine months. This one every nine months rubric has been around for a long time.

The focus seems to have shifted from providing a tax based incentive to serve a broad public policy to viewing qualified plans as a tax loophole which needs to be shut down to avoid exploitation by unscrupulous employers. The sheer volume of statutory and regulatory material has exploded. When the author graduated from law school, the Internal Revenue Code, the paperbound version, was one volume and the regulations were two volumes. The number of pages of statute governing pensions totaled sixty-five, whereas, in 1992 there were 699 pages. Regulations in the same time period have expanded from 306 pages to 3,627 pages.

The IRS has now actively begun to disqualify plans. The regulators, both the IRS as well as the Labor Department, who now come in and audit plans and say, well for the last ten years you should have been doing it this way, never mind that we didn't tell you, you should have known. Your plan is now disqualified and you owe all of it in taxes. If you think this is not true, look at the 1994 case of John U. Fazi, and the other adverse developments not reported in that case.

The 1993 tax change to reduce compensation that can be counted in funding a retirement plan from $235,840 to $150,000, has had a profoundly negative impact on the ability of small firms to maintain pension plans for their owners and employees. Described as another tax on the rich, it actually works to reduce the pension of employees earning as little as $35,000. Since pensions are eventually taxed when distributed, the economy is hurt in two ways. First, the pool of investible capital is reduced, and second, future tax revenues are reduced as new pressures are added to our long term deficit outlook. For the owners and employees, it means a less secure retirement.

Unlike larger firms, the realities of the tax laws make it nearly impossible for a small firm to provide nonqualified pension benefits, stock options and other PERKS. Most small firms cannot now plan to use a defined benefit pension plan due to the impossible complexities of one specific 1994 GATT change on calculating lump sum distributions. This one change should be repealed!

The provisions in Internal Revenue Code Section 415 limit the maximum lump sum benefit allowed to be paid to a participant. This lump sum removes the individual participant from the protection of a pool of funds and places all the risks squarely on the shareholders of one life. In order for that lump sum to produce an annual pension for the life of that individual, many risks must be balanced. These would include investment volatility, expenses and cash flow as well as the possibility of living much longer than the average. It is possible that if the annual benefits were being paid from a large plan with many participants and a huge asset pool, the lump sum needed by that plan may be properly determined using a 30-year Treasury rate, as required by the 1994 GATT change. However, once the lump sum amount is separated from that pool and given to an individual, the proper interest rate for determining the lump sum payment could arguably be much lower than the 30-year Treasury rate which would result in a much greater Single Sum Distribution.

This change is a clear benefit cut back for those participating in a small pension plan. For the participant in a large plan, this change could simply result in a decision to take the annual payments instead of the Single Sum Distribution, but for the participant in the small pension plan where plan maintenance after retirement is less likely, GATT has just cut the benefit allowed by over 20%. This is clearly a step away from the Tax "Equity" between participants in small plans and participants in large plans.

Not only have maximum benefits been cut significantly, but the new limits are based on a market rate that changes every month. The fact that the maximum Single Sum Distribution was based on a fixed interest rate was extremely practical for plans covering a small number of participants. By having a fixed rate (5%), the plan could fund for a fixed funding goal. As a result, the required contributions were relatively stable and consistent from year to year.

Now that the limit will be based on a fluctuating market rate, this stability will be lost. For example, suppose that the GATT bill provisions for maximum benefits has been in effect since 1980. If the maximum annual pension had remained fixed at say $90,000 per year age at 65, the maximum Single Sum Distribution at age 65 would have varied from $587,720 to $1,042,250 during that period (the 30-year Treasury rate has ranged from 5.94% to 14.68% in the past 15 years). If a participant was age 50 in 1980 and the $90,000 annual benefit was projected for that individual at age 65 in 1995, what Single Sum Distribution amount should have been targeted?

This kind of moving funding target becomes very disconcerting when we add the 50% excise tax for reversions due to overfunding on one side and the 10% to 100% excise tax for failing to meet minimum funding requirements on the other side! Because of these penalties, it is even more difficult for the small plan sponsor to fund for and receive maximum allowable pension benefits, whereas these potential penalties would not be an issue for recipients of maximum pensions from large pension plans.

Anyone who earns a maximum pension under a defined benefit plan where single sum distributions are offered will be affected. This could include outside directors who participate in a 100% of pay pension plan for directors, highly compensated employees from any sized plan, mid-level management in plans offering subsidized early retirement with lump sum settlement, and employees at any level who participated heavily in both a defined benefit plan and a defined contribution plan and whose pension maximum is reduced by special combined plan limits. See Klingler, RIA, Pension & Benefits Week, Dec. 12, 1994, p. 9.

THE $150,000 COMPENSATION CEILING TRAGEDY

For small business, the qualified defined contribution pension plan is their only real option for retirement savings. But the uncertainty of their economic survival may delay instituting a plan until key employees and founders had reached an age at which standard benefit formulas would not provide a sufficient retirement income. With the $150,000 compensation rollback, much of their current compensation would be excluded. Enriching the benefit formula is not an option since the cost would be prohibitive. Faced with this dilemma, the fear is that owners might choose to abandon the plan. This is not an unreasonable fear as the enclosed chart reveals that the tax advantages of pension plans for small business owners is shrinking significantly.

The problem with the rollback in compensation to $150,000 is not limited to defined contribution plans and the owners of small businesses. Defined benefit plans and the pension security of younger, low wage participants in these plans will also be threatened because of the limits placed on actuarial funding contributions. For example, using reasonable actuarial projections about future salary growth, an employee expected to retire in 30 years need only be making $35,000 today to be impacted by this rollback since the projection shows that at age 65, this 30 year old will be making $165,000. Because this exceeds the new limit, the funding contribution of his employer would not cover the entire benefit being projected. When a plan has many employees in this group, its funding would be severely impaired, posing risks for the employees as well as for the PBGC.

Another problem presented by the rollback of covered compensation to $150,000 arises for the popular 401(k) plans offered by both large and small employers. Because these plans have nondiscrimination tests which they must pass, it is quite likely that the limit will force a reduction in the percentage amount of compensation that higher paid individuals can contribute on a pre-tax basis. If historical experience is a gauge, the reductions in contributions will fall most heavily on those employees earning $60,000 to $75,000 a year. These and many others are not within the class of highly compensated that the proponents of this rollback said should lose the benefits of tax deferral.

The consequences of this cut are predictable, although not readily discernible. The slowdown in funding, the reduction in tax deferred retirement savings for employees earning $60,000 and up, the potential threat of losing a pension promised by a non-qualified plan, and the likelihood that a small plan might be terminated are real risks that are being sacrificed on the altar of deficit reduction. When this government is outspending its ability to collect revenues by more than $200 billion a year, it seems to us that the $500 million a year that this rollback gains could easily be offset by minor reductions in government spending that would have far less impact on far fewer Americans.

REGULATORY COMPLIANCE BURDENS AND THEIR IMPACT ON RETIREMENT PLANS SPONSORED BY CLOSELY-HELD AND FAMILY BUSINESSES

Today, closely-held businesses employ approximately 60% of all employees in the Nation. Providing fringe benefits and retirement plan coverage for these employees has been greatly hampered by extraordinary compliance burdens imposed by the Congress and the Internal Revenue Service. The costs of maintaining a retirement plan for a small business on a participant to participant basis is as high as 10 to 1 (Mitchell & Andrews, 1981). These costs are largely the result of complex administrative requirements imposed by too many legal changes and the accompanying regulation.

For whatever reasons, there has been for years a belief that employers can absorb the costs of whatever increasing administrative burdens are thrust upon them. In our opinion NO cost should be thrust upon an employer that can possibly be used more profitably by that company elsewhere (including additional benefits for its employees) unless it is clearly demonstrated that the administrative burden is necessary for the proper and effective working of the plan.

Six years ago, Congress recognized this problem and repealed the onerous Section 89 fringe benefit rules. However, a series of laws since ERISA was passed on Labor Day, 1974, have crippled our nation's retirement system for private employers. During the last decade the cost/benefit ratio of sponsoring a retirement plan has gone out of whack because costs have increased significantly while benefits have declined dramatically. Data derived from Internal

Revenue Service determination letter requests indicates that new retirement plan establishments have declined by at least 70% in the last 9 years. The decline for new defined benefit plans is even more precipitous - a drop greater than 80%. Conversely, termination of plans has increased markedly - more than 100% in the last 9 years. This decline is due in large part to the additional costs and complexity injected into the private retirement system over the last decade by Congress and the Internal Revenue Service while at the same time the benefits which can be provided by a retirement plan have been severely curtailed.

Today the laws governing the retirement plan system confound the "best and the brightest." By this, we mean even the elite of the pension world - the practitioners who work exclusively in this area as well as the people at IRS and Treasury working at the very highest levels. Few, if any, of these practitioners, can honestly say that they completely understand the ERISA and pension law in its present state or that the plans they represent are operating fully in compliance with the law at this time.

NEEDLESS COMPLEXITY AND CHANGE IN THE PRIVATE RETIREMENT
SYSTEM AND ITS NEGATIVE IMPACT ON PENSION COVERAGE

One of the outstanding tax practitioners in the country, Mr. Harold Apolinsky, from Birmingham, Alabama, wrote to Mr. Kenneth Gideon when he was Assistant Secretary of Tax Policy at the Treasury Department, "You may recall that Wilbur Mills insisted that there be 15 years between major tax laws. We had the 1939 Code, the 1954 Code, and what we thought (erroneously by today,s standards) was a major tax bill in 1969. Such a time frame allows the taxpayers, their advisors, and those of you in tax administration to become comfortable with the system. It is constant change which is the problem."

Mr. Apolinsky **has determined that there have been over 10,000 changes to the Internal Revenue Code sections since 1980.** The frequency and complexity of these changes in the retirement plan area is greatly exacerbated by IRS regulations which can be any or all of the following; untimely, effective retroactively, or difficult to comprehend even by specialists. Often needed regulatory guidance is not issued until after a qualified retirement plan has had to comply with the law change. In some cases, the change is so incomprehensible that IRS basically suspends operation of the law until it can figure out what to do with the change - for example, the changes made to the integration rules by Congress.

Ten years ago, when the voluntary retirement system was stable and the rules were clear, the system was flourishing and retirement plans were being established by privately held companies in record numbers. We know from tax advisors from all over the country that retirement plans for small businesses were being established in record numbers. Stable small businesses were adopting plans because it became evident to the owners of these businesses that a qualified retirement plan was the best way to save for retirement and to retain good staff employees. Costs of the plan were in a good balance with the benefits to be derived from the plans - so plans were being adopted.

Data which supposedly shows the opposite is flawed - the data is based upon a time period that precedes the boom period of the late 70s when plans were being adopted in record numbers. Costs to administrators and pension specialists were reasonable and companies were able to take actions knowing what the results would be. The system was working.

If the law returned the system to its prior relative simplicity, reliability and clarity even while retaining the reforms that have been injected into the system during the last several years, the voluntary private retirement system would become rejuvenated. The second step in restoring the system to its prior viability would be to restore retirement benefits to the level they were at prior to the onslaught of legislation.

THE ROLE OF SIMPLIFIED EMPLOYEE PENSIONS (SEPs)

SEPs have not been utilized to any meaningful extent by small business. This may be because an SEP is antithetical to small business management. Money contributed to a retirement plan by small business is money that would otherwise have gone back into the business or the owners could have taken out themselves as income. Most owners are only willing to enter into a retirement plan if it is perceived as a true benefit by the employees and the owners. It appears that at least some employees (and our guess is more than some) do not even view an SEP as a retirement plan but instead see it as a bonus program. Unfortunately, the lack of governmental regulation and supervision allows the SEP plan to be a target for abuse.

We understand from bankers, attorneys and advisors throughout the country that many, if not most, non-highly compensated employees immediately take the money out of the SEP. In contrast, with a retirement plan, the company only pays out the retirement benefit to an employee when the employee terminates employment, dies or becomes disabled. When the check is paid over, it is clear to all parties concerned that the employee has received a real benefit from the company. And many employees of small businesses receive very good retirement plan benefits, which because of plan design are almost always portable. The benefits are good because they must be good in order to provide the key employees with meaningful retirement benefits. Remember in the small business context, the retirement plan is the primary method available to owners to fund for their retirement. And the law ensures that plan contributions for all employees, key or otherwise, must be non-discriminatory. Simplification of the underlying system is the answer - not enhancing or expanding a program which is not really a part of the retirement plan system and considered by many small business employees as merely a bonus plan.

Another proposed solution is to have IRS model or prototype plans which would allegedly increase retirement plan coverage. There is little reason to think that an IRS prototype would afford a small business any more than a brokerage or insurance company prototype. The rules that are necessary to properly design, implement and operate a retirement plan are what are so complex, not the underlying plan document. Thus, this approach would do nothing to entice small business to sponsor retirement plans.

SIMPLIFY THE SYSTEM: OUR PROPOSALS

The following proposals are respectfully offered, for changes to the present law which could simplify the administration, and thus, the costs of maintaining retirement plans. These changes would be a necessary first step to revitalizing the system for small business. As retirement plan experts, we believe these simplifying proposals would retain the underlying change effectuated by Congress over the last ten years.

- **Eliminate the Top-Heavy Rules under Code Section 416.** The American Bar Association Tax Section recommended this years ago. These rules provide for accelerated vesting, minimum benefit accrual and a limit of $200,000 on the amount of compensation that can be taken into account under a qualified plan if more than 60% of the benefits under the plan are payable to key employees. Because of many of the changes enacted under the 1986 Tax Reform Act, including the new coverage and participation rules, new vesting standards, strengthened integration requirements, the top-heavy rules are unnecessary.

- **Repeal the family aggregation rules**, which discriminate unfairly against spouses and children employed in the same business.

- **Delete the $150,000 Compensation Ceiling.**

- **Delete the definition of key employee and replace it with the definition of highly compensated employee.** All retirement plans should be able to utilize the same vesting schedules regardless of size.

- **Adopt the design based 401(k) safe harbors of former H.R. 13, which has been passed by both House and Senate.**

  Many companies would choose to stay outside the safe harbor because it is more cost-effective to stay with their current system. On the other hand, particularly for small employers, a voluntary safe harbor that does away with costly complex testing which entails significant cost may prove to be enough of an incentive for the company to go ahead and sponsor a §401(k) plan.

- **Repeal, or modify Code Section 401(a)(26) to apply only to defined benefit plans.** The reach of the proposed regulations is so broad that almost all plans, except the most elemental, will be subjected to this code section. These proposed regulations are the antithesis of simplification and can be expected to waste taxpayer and IRS dollars.

- **Simplify the definition of Highly Compensated Employee.** The definition of highly compensated employee which applies a number of highly complex rules to four basic definitions should be streamlined to a single rule that says that any employee who earns over $75,000 (indexed) is a highly compensated employee.

- **Repeal the GATT change on lump sum distributions from defined benefit plans.**

- **Modify the full funding limitation.** Code Section 412(c)(7) was amended to prohibit funding of a defined benefit plan above 150 percent of current "termination liability." This is misleading because termination liability is often less that the actual liability required to close out a plan at termination, and the limit is applied to ongoing plans which are not terminating. In effect, current law inappropriately mortgages benefit promises by prohibiting the level funding that is the reasonable way for plans to fulfill benefit obligations and, instead, requires plans to be funded with payments which escalate in later years. Instead, the full funding limitation should be based on ongoing (projected) liabilities, and not on termination liability.

- **Simplify the rules on affiliated service groups and leased employees under Code Section 414.** Overbroad language in the statute and overbroad regulations issued in proposed form have combined to create artificial affiliations which do nothing to promote the integrity of the retirement plan system. Solution: Have Congress give greater direction to the IRS on the types of abuses to be covered.

- **Eliminate the excise tax on excess distributions.** The rationale for maintaining such taxes, the prohibition against excessive accumulations, is outweighed by the complexity of the provisions. This provision was initially intended to take the place of the complex §415(e) calculations. However, since §415(e) was not repealed, the excise tax is unnecessary. Alternative: repeal the absurdly complex Section 415(e) fraction. Actuaries report that the calculation of the §415(e) fraction to be extremely complex. Rumors persist that this fraction is only reviewed by IRS in the context of privately held companies.

- **Repeal new Code Section 401(m) and the multiple use limitation.** Subjecting matching contributions to the §401(a)(4) rules and defining voluntary after-tax contributions as annual additions for purposes of the §415 limits provides sufficient restrictions on the use of such Contributions. <u>The new voluntary designed based safe harbors set forth under the Tax Simplification Bill should greatly assist small plans which provide employer matches in their §401(k) plans as an incentive to increased employee retirement savings.</u>

- **Eliminate Code Section 414(o).** This section provides a broad grant of regulatory authority to the IRS to deal with business arrangements which would allow circumvention of the qualified plan requirements. This section should be eliminated because it has made it virtually impossible for a sole proprietor and other small businesses to determine eligibility for plan contributions when it is involved in any way with another entity.

- **Simplify notices for required annuity distributions.** Solution: Notices of such annuities should only be required upon commencement of employment and when requested thereafter.

Finally, the IRS must halt the overt discrimination which is occurring in the so-called small defined benefit plan audits and it should never undertake an audit where it is applying new standards retroactively on a group of taxpayers that are perceived as "too small" to litigate. The Administration must not be allowed to dictate to IRS how much it is to receive from a targeted audit group - in this case IRS was to collect $660 million in 2 years from small business defined benefit plans. This is, plain and simple, reprehensible. To go after a class of taxpayers because it is known they do not have the deep pocket necessary to litigate cannot be tolerated. This program is unseemly - secret memos requiring agents to impose retroactive guidelines on small plans, key officials at IRS and Treasury publicly stating they know nothing of the program, and forcing the public to obtain the data through Freedom of Information. Even though justice prevailed in the Tax Court and at the Appellate level - this program has not only hurt the small businesses involved financially and the actuarial community who were forced to defend prudent actions, but in the long run it will also hurt the Service.

Even now taxpayer dollars are being expended in the continuation of Appeals. Of great concern is that the taxpayer may begin to see the Internal Revenue Service as an unfair and unprincipled entity. This is disastrous for a tax system that largely relies upon voluntary compliance. It will not be enough to simplify the system if companies know that by sponsoring a retirement plan, they are basically "buying" an audit.

CONCLUSION

The private retirement system has been in a decline for the last several years. This is the result of (1) additional and largely unnecessary costs and complexity injected into the private retirement system over the last decade, (2) a concomitant reduction of benefits to retirees, and (3) a dramatic downturn in the economy. It is not clear how much the system has been harmed by the cutback in benefits as compared to the increased costs of complexity. It is clear, however, that the needless complexity is a real threat to the continued health of our private retirement system and that the system can be simplified without adversely impacting revenue or the underlying policy of the changes.

Voluntary design based safe harbors are the most effective way of truly simplifying the complexity inherent in the retirement plan system. This is the solution advanced in the §401(k) area. The §401(k) plan is an exceptionally popular plan with both employees and employers. The Tax Simplification Bill set forth two design based voluntary safe harbors in the §401(k) area. These safe harbors promote this popularity by making the administration easier. A company can elect to fall within a safe harbor or not. This is a novel and sound approach to simplification which should be utilized in other complex areas of the retirement plan system.

The voluntary retirement system was healthy and growing before the onslaught of constant changes in the law and regulations. New plans were being established by small businesses in record numbers. Simplification of the underlying system, particularly by the use of voluntary safe harbors, will go a long way towards reviving the system.

Last year, the National Institute on Aging (NIA) reported that millions of Americans in their 50s face an uncertain future, lacking health insurance or pensions, or fearing that they will lose the benefits they do have. The survey by NIA found that a substantial number of people -- especially minorities -- lack pension coverage that may rob them of a satisfying and successful retirement.

The findings, while shocking, do not come as a surprise to benefits professionals. Most of us are aware that in recent years the focus of America's retirement and employee benefits policy has shifted dramatically for the worse. Those of us concerned about the viability of the private benefits system know all too well that the budget deficit and not retirement and savings objectives, has driven almost all debate on important national issues, including retirement matters.

In March of 1993, the American Academy of Actuaries reported that since 1988 at least 50,000 of America's small business firms -- those with less than 25 employees -- have eliminated their defined benefit pension plans leaving their workers without retirement plans. An equal number of small firms, according to the Academy, chose to replace their defined benefit plan with a defined contribution plan. The Academy's data is confirmed by the U.S. Department of Labor which reported in its initial Private Pension Bulletin that defined benefit plans had decreased by 24% between 1983 and 1989. The DOL reported that the trend shows that we are no longer seeing a growth in the number of plans nor is the percentage of the workforce with pension plans growing. Indeed, while the workforce grows, the percentage of covered workers falls (albeit, there was a small increase in 1992).

This drop in pension plan coverage could not come at a worse time. The graying of America, and the burden that it will place on future generations, can not be ignored. The American Council of Life Insurance reports that from 1990 to 2025, the percentage of Americans over 65 years of age will increase by 49%. This jump in our elderly population signals potentially critical problems for Social Security, Medicare and our Nation's programs designed to serve the aged.

While we must assure our citizens that Social Security and Medicare will remain strong and stable, private pensions, savings and private Sources for retiree health care will have to play a more significant role for tomorrow's retirees. The savings that will accumulate for meeting this need will contribute to the pool of investible capital that will provide the economic growth needed to finance the growing burdens of Social Security and Medicare. But such savings will not be forthcoming in the face of the kind of policy directions reflected by the Administration proposal.

While many factors can be cited for the crisis, two stand out -- DIMINISHING TAX INCENTIVES and INCREASED COSTS DUE TO

OVERREGULATION. The loss of tax incentives appears to be directly related to our nation's budget deficit problems. Reducing the tax incentives for pensions is destructive of our goal of having an adequate retirement savings system.

Frequently, the case for reducing the incentive is premised on dubious assumptions that the current incentives are not functioning as expected. Often times, advocates for reducing tax incentives employ the politics of envy. Both the Association of Private Pension Plans and the Employee Benefits Research Institute have recently published treatises that punch holes in the logic of those advocating reduced tax incentives for retirement savings. While defending current tax incentives is commendable, what's really needed are new tax incentives to overcome the losses of the past decade.

The other factor that is contributing to the stagnation of private pension and welfare plans is the unrelenting drive to suffocate our private benefits system with questionable costs due to increased burdens imposed by regulation. In the above mentioned American Academy of Actuaries study the reason most given for abandoning a pension was the growing burden to comply with government regulation. Nearly 60% of small employers in the Academy cited the cost of compliance as the primary reason for their decision to terminate a defined benefit plan. Almost 30% of large firms cited this factor also.

Despite the increasing evidence that we are drowning employers in regulations, the push for more regulations and laws appears unrelenting while the drive to simplify compliance is locked up in legislative stalemate as is the case for the laudable Pension Simplification Bill.

This statement was largely prepared by Al Martin, Esquire, the President of the Small Business Council of America, ("SBCA"). He is also a practicing attorney in Kansas City specializing in tax, business and pension law. Much of his work is spent with family business as well as privately-owned, closely-held businesses.

STATEMENT BEFORE
HOUSE COMMITTEE ON WAYS AND MEANS
BY GERALD B.H. SOLOMON

Mr. Chairman and members of the Committee:
I appreciate the opportunity to testify in support of those areas of the Contract With America which fall under the jurisdiction of this Committee.

As a Representative of the State of New York which has one of the highest per capita tax burdens in the country, I am well aware of the disastrous impact heavy taxation and regulation can have on families, businesses and local economies. I applaud those proposals of the contract which seek to alleviate these tax burdens, stimulate investment and free up capital.

However, as both a deficit hawk and a fiscal conservative I am concerned that corresponding measures to reduce spending, restructure the government, and balance the budget may take a back seat in priority to those proposals to cut taxes. I believe they both can and must be done simultaneously. My rational for this position does not come from my view of the relationship between tax cuts and their impact on the economy.

Let me assure my Republican colleagues on the Committee that I do believe a smaller tax burden on both business and families will result in stronger economic growth and hence greater federal revenues. I particularly favor reducing the capital gains tax rate, increasing the estate tax exemption, and expanding Individual Retirement Account rules.

Nevertheless, I am reminded of what this Congress did back in 1981 and 1982. I am not referring to the alleged claim that President Reagan's tax cuts caused today's high deficits. A thorough and honest examination of the facts shows these subjective accusations to be completely unfounded. As a matter of fact, I still consider my "yea" vote for that tax cutting package to be one of the most important decisions and votes that I have cast since becoming a member of this body. Consequently, I do not believe that passing tax cuts now will inevitably result in higher deficits. However, my memory is plagued by the Congressional promises given President Reagan in 1981 and the revocation of those promises in 1982. In negotiations, the Democrat leadership of this Congress and President Reagan made a deal to cut taxes in 1981 and to cut spending in 1982. Unfortunately, the promised spending cuts never appeared. I firmly believe we must ensure that both occur now.

Many of you are aware of my efforts to balance the budget through a fundamental restructuring of the federal government. By consolidating similar programs, eliminating obsolete functions and privatizing certain services, government actions can be pared back to a size closer to a level of government revenues that is less restrictive and burdensome. I realize that reducing spending for various programs does not necessarily fall under the jurisdiction of this Committee but we all favor a government that costs less and yet does what is constitutionally required of it. Furthermore, as this Committee is tasked with the job of determining how best to generate adequate federal revenues while also ensuring long term multi-sector economic growth, it is imperative that this Committee do its part in assuring that spending and taxes be reduced correspondingly.

One area of the Contract under the jurisdiction of this Committee which I believe can result in a smaller and yet more efficient government is H.R. 4, "The Personal Responsibility Act of 1995." Our nation's current welfare system is wrought with waste, fraud, and abuse as welfare has become a way of life for many people. For over forty years the welfare system has been paying for non-work and single parenthood at increasingly alarming rates. Examine these revealing statistics.

Twenty-seven million American families presently collect food stamps. A record high of 5 million families (with 9.6 million children) are currently enrolled in the AFDC program - up from 3.7 million families in 1988. 92% of the children on AFDC do not have a father in the home. Fewer than 1% of AFDC parents are now required to work. Out-of-wedlock births among children 15-to-17 years of age have more than doubled since 1965. Funding for the twenty-five major social welfare programs doubled from $132 billion in 1975 to $277 billion in 1992. These facts are the results of a system that subsidizes out-of-wedlock births, penalizes marriage, creates dependents out of able-bodied citizens, and discourages recipients from breaking out of this detrimental cycle. Rather than alleviating social pathologies such as crime, drug abuse and academic failure, the current welfare system has contributed to them.

I believe a fundamental approach to welfare reform must address three major areas: it must end the subsidy of illegitimacy, enhance work requirements, and impose concrete spending control measures. I believe H.R. 4 meets this criteria.

Consistent with the taxpayer's demands for lower taxes and cuts in spending are their demands for time limited welfare benefits, stricter spending enforcement mechanisms, an end to illegitimacy and a rededication to the principles of family, personal responsibility and a work ethic. Many Americans work diligently eight to ten hours a day for five and six days a week, giving large sums of their income over to the federal government only to watch how it is wasted and pilfered on the evening news. The taxpayers desire fundamental change and not merely a reform of the status quo. For example, if a program designed twenty years ago to assist unwed mothers has not worked, it should not merely be fixed. It should be abolished and a new program that recognizes root causes and the role of the federal government in meeting those challenges should be erected instead.

I applaud those portions of H.R. 4 which correctly recognize the state as the primary entity to fight poverty. Resurrecting the timeless principle of federalism will enable individual states to determine for themselves how best to approach the welfare dilemmas indigenous to their state. Again, representing the state of New York with one of the largest welfare roles in the nation, I believe both the state and the nation would be best served if New York were allowed to devise its own programmatic solutions.

A one size fits all approach to poverty and illegitimacy as currently exists with Food Stamps and Aid to Families With Dependent Children clearly has not worked. I believe the bold approach of capped block grants with specific but limited strings attached offered by H.R. 4 is the answer.

Furthermore, I also strongly support the cap on the aggregate growth of welfare spending. As this Committee is well aware, the total cost of the "War on Poverty" has been enormous. From its inception in 1965 to the present, welfare spending has cost the taxpayers $4.9 trillion in constant 1992 dollars. This is even greater than the entire national debt. Total welfare spending now absorbs 5% of the Gross National Product, compared to 1.5% in 1965. In 1992 welfare programs alone cost $305 billion and this number is projected to increase by $510 billion by 1998. With welfare spending rising significantly from year to year and the welfare dependency roles rising as well why does the federal government continue to pour more money into a program that clearly has not stemmed the tide of poverty?

Mr. Chairman, the Bible tells us that the poor will always be with us but that we should care for them. Despite this truth, the government should focus its limited resources on those programs which truly make life in poverty shorter and more reasonable.

Capping the growth of welfare spending at an amount equal to the sum spent the preceding year, adjusted for inflation and a tight poverty population index is consistent with our fiscal realities and our duties to community and society.

Reforming government through reducing taxes, spending and eliminating the deficit while promoting individual responsibility, civic duty and limited government is the recipe for real change.

I commend this Committee for the laudable work I am confident it will do.

Mr. Chairman, I believe you described our task as the People's Congress best when you wrote "Our obligation to the American people remains the same today as when it began - asking the people for the strictest minimum taxes so that the smallest government possible can help people do what they otherwise cannot do for themselves."

I thank the Committee for its time and consideration.

TESTIMONY OF THE HONORABLE BART STUPAK
Before the House Committee on Ways and Means
January 10, 1995

Chairman Archer, Ranking Member Gibbons, and Members of the Ways and Means Committee:

I appreciate being given the opportunity to appear before you today to share my thoughts on our great national debate over the role of government and on the Republican "Contract with America."

I welcome the opportunity to give my thoughts on proposals contained in the "Contract." My constituents and I support many of the points outlined in the plan, and I look forward to working with you in the days ahead on this package.

There is much promised in the "Contract with America" which I like. Tax relief for middle-class families and senior citizens. Welfare reform. A balanced budget amendment and reduced federal spending. All of these measures are things which I have long-supported.

While I support many of your ideas, I am deeply concerned over the financing measures -- or lack of financing measures -- contained in your plan. In reading the "Contract with America," I am reminded of the lengthy Christmas lists which my two sons used to put together when they were younger. These lists sounded great, and like all parents, my wife and I would have liked to have been able to fulfill every Christmas wish our kids had. But as adults, we knew that giving a child every toy he wants isn't responsible or possible. As Members of Congress, we are in that same position today.

Mr. Chairman, the people of Michigan's First Congressional District didn't elect me Santa Claus. They elected me their Representative in Congress. With that election, I signed <u>my own</u> contract -- a contract with the people of Northern Michigan. I promised my constituents that I would come here to represent their best interests with every vote I cast. I vowed that I would make the tough decisions needed to get our economic house in order and relieve the crushing burden of debt and deficit that threatens our nation and our children and grandchildren's future.

The Balanced Budget Amendment portion of the "Contract" alone will mandate $1.2 trillion in budget cuts by the year 2002. The Personal Responsibility Act will cost $12 billion. The Family Reinforcement Act will cost $8.9 billion. The American Dream Restoration Act will cost $112.3 billion. The Senior Citizen's Equity Act will cost $25.1 billion over five years. The Job Creation and Wage Enhancement Act adds up to $46.5 billion in spending. Mr. Chairman, that's some Christmas list -- $204.8 billion for just these proposals.

Keeping these concerns in mind, I would like to take a moment to relate some of my thoughts on the specific portions of the "Contract" within your Committee's jurisdiction:

The Fiscal Responsibility Act

We all share the desire to balance the federal budget. Deficit reduction has been a common goal. Realizing that we did not get into our economic mess overnight and that, according to the bill, we have only seven years in which to balance the budget, it is apparent that we will be faced with very difficult spending choices. If our experience with the Penny-Kasich plan forwarded in the 103rd Congress is any indication, it will be difficult enough to "finance" a balanced budget amendment <u>without</u> all of the other tax breaks included in the "Contract." While I am pleased that the Fiscal Responsibility Act will also provide a line-item veto to allow for further reductions in wasteful and unwarranted spending, it is difficult to fathom how we will reach a balanced budget in seven years while also providing billions of dollars in tax cuts with sharp increases in defense spending. In fact, it sounds a lot like the failed trickle-down economic plans I heard about in the 1980's. Finally, and for the record, I will only support a balanced budget amendment that takes Social Security off budget. The Republican amendment does not do this.

<u>The Personal Responsibility Act</u>

Shrinking the size of federal bureaucracy and reform of the welfare system are bipartisan goals which I support. While the federal government may be bigger than the framers of the Constitution envisioned, the role of the American government remains the same: to protect and better the lives of the people who live within its borders.

The PRA is a departure from the principle of "mutual responsibility" that should guide bi-partisan welfare reform efforts. Under this principle, which I support, welfare recipients are expected to move toward self-sufficiency by participating in education and/or training, by working, or by looking for work while the government agrees to maintain a basic safety net beneath poor children and families. While our current system is certainly partially to blame for creating a class of dependents, the PRA abandons the government's side of this important mutual responsibility.

I fear that the bill could deny basic income support to numerous families in the Michigan's First Congressional District. This will include many families where parents are complying with the law, and are willing to work, but cannot find a job. Representing the district with one of the highest unemployment rates in the State of Michigan, this is obviously a concern.

I am also concerned with how the PRA deals with food assistance programs. According to the Michigan Department of Social Services, the PRA would cut an estimated $18 billion over four years from food assistance programs. Virtually all domestic food programs, including food stamps, WIC, Senior Nutrition Programs under the Older Americans Act and the school lunch program would be consolidated into one block grant. In FY 94, roughly $835 billion in federal food stamp dollars came into Michigan. As of September 1994, 977,728 people in 411,257 households received food stamp assistance. Furthermore, persons over 60 years old accounted for 42,601 of total food stamp households. I wonder what effect the consolidations of these programs will have on these vulnerable populations. The proposal may also have the unintended result of harming small businesses whose clientele use foods stamps.

We must be careful in our struggle to reform the welfare system not to dismantle the safety net that provides vital support. To throw thousands of people into the street without some assistance to help them stand on their own two feet is immoral and penny-wise. We must also be careful not to adversely affect hard working men and women whose businesses don't differentiate between a dollar and a food stamp. While I strongly support making all able-bodied people work, we must accomplish these goals in a way that is both tough and smart.

Family Reinforcement Act

Many of the components of this proposal are sound. I have long supported adoption as a means to curtail the use of abortion as a form of birth control. However, like many provisions in the contract, it is replete with tax deductions and credits. It is estimated that enactment of this provision could cost $8.9 billion dollars, yet it fails to provide the corresponding spending cuts necessary to pay for it.

American Dream Restoration Act

Mr. Chairman, on May 25, 1993 on the floor, you said, "Most economists say the biggest problem in the United States today is a lack of savings."[CR, 5-25-93, pg. H2784] I fully agree. The theory behind tax free IRA's is sound, and will inevitably provide some measure of relief for the greatest number of taxpayers. I would go further and ask the Committee to look into provisions that could allow those without IRA's a targeted tax break by not taxing earned interest on basic savings accounts. In this way, we reward not just those who are fortunate enough to have IRA's or those who play the stock market, but those working men and women that are just getting by.

I am, however, concerned that provisions like $500 tax credit per child for families that make $200,000 is unnecessary and costly. Furthermore, those living below the poverty rate, with no tax liability, would receive no benefit.

Again, Mr. Chairman, dollars are scarce. We should not be frivolous in opening up the treasury to the wealthiest taxpayers in the country at the expense of working and middle-class families.

The Senior Citizens Equity Act

I have in the past and will continue to support efforts to raise the "earnings test" threshold which discourages seniors who collect Social Security from working full time. Social Security is a sacred compact and seniors should not be penalized from working as much as they are able simply because they are receiving Social Security benefits.

In regard to provisions in the "Contract" to repeal the 1993 increase in the portion of Social Security benefits subject to taxation, I fear that we may be taking a step backwards. Only 13% of all Social Security beneficiaries were affected by this change. The tax code needs to remain progressive and based on "ability to pay." Whether the filer is single, married, or a senior, everyone must share the burden of deficit reduction. While that may not be politically popular, it is the truth.

The Job Creation and Wage Enhancement Act

I agree with many of the components of this bill.

I have long been a supporter of mandatory cost benefit analysis and risk assessment in the federal regulatory and rule-making process. I voted against legislation to elevate the EPA to a cabinet position, not because I believe the EPA is unworthy of cabinet status, but because significant "cost" and "risk" language was left out of the bill.

Furthermore, I have always supported private property rights whether in regard to "takings" legislation or legislation designed to protect against other instances of government intrusion.

Finally, as a former state legislator, I am well aware of the problems facing state and local governments in regard to unfunded federal mandates. In the 103rd Congress, I strongly supported H.R. 140, legislation to require the Federal government to include a funding mechanism in any legislation that mandates state or local compliance with Federal laws. I fully believe that Congress must act more responsibly when imposing spending mandates to predetermine any adverse effects they might have on the states.

I must express concern over the scope and cost of the proposed fifty percent exclusion from the capital gains tax. I do support the indexing provision, however, it has been estimated that the exclusion could cost up to $56 billion dollars over five years, and like many proposals in the contact, there is no indication of how this cut will be paid for. While I understand that such a cut is not simply a give-away to the wealthy, I also understand that this provision will not pay for itself. As previously noted, I would be far more inclined to support a cut that benefits many Americans, like a cut in taxes on interest, than one that benefits such a narrow band of taxpayers.

I have many other thoughts on the Republican "Contract with America," and look forward to discussing them in further detail as the package makes its way through the legislative process. The days ahead will hold many difficult choices and countless painful decisions. I appreciate the opportunity you have given me to testify here today, and would like to leave you and the members of the Ways and Means Committee with one assurance and one pledge. I assure you that I will put aside party politics in a spirit of bipartisan cooperation to work with you in these coming weeks to pass those portions of the Contract with America that will benefit the people of my district, and this nation. But above all, I pledge to remain true to my own Contract with Northern Michigan, and oppose at every turn any part of your package which passes the buck to my constituents and their children or dodges the tough choices that I was sent here to make.

Mr. Chairman, postponing these hard choices until another day may be easy and politically safe, but <u>my</u> contract simply won't allow it.

Testimony of U. S. Rep. C. W. Bill Young
before the House Ways and Means Committee
on the Contract with America
January 10, 1995

Mr. Chairman and members of the Committee. Thank you for the opportunity to appear before you to testify in support of the Ways and Means portion of the legislation that comprises the Contract with America. The members of this Committee have a historic opportunity to deliver the kind of genuine change the American people asked for in November, and I look forward to working with each of you to implement key legislation before your committee that I have long supported.

As the Congressman from Florida's Tenth Congressional District, a Congressional District which is home to a large population of senior citizens, I am pleased to be testifying in favor of the Senior Citizens' Equity Act. One of the first bills I ever introduced in Congress was to repeal the Social Security earnings limitation, and I have consistently cosponsored legislation that would overturn the unfair limit on outside income which penalizes older Americans for working. While the former House Leadership failed to allow us to debate this legislation on its own in the House, and prohibited us from raising it as an amendment to any other pending legislation, I am pleased that the Committee has committed to raising the earnings limit from $11,160 to $30,000 over the next five years. I will actively press for this legislation because I firmly believe our nation can benefit greatly from the skills and experience of older employees. Another portion of the Contract that I strongly support is the repeal of the 1993 Clinton tax increase on Social Security benefits. I opposed the original legislation that required senior citizens who earn more $34,000, or couples earning more than $44,000, to pay income taxes on 85-percent of their Social Security benefits. I cosponsored legislation in the 103rd Congress to repeal this onerous burden, and I will support the current legislation to roll this tax back over five years to the pre-Clinton levels.

Mr. Chairman, you are well known for your work to cut the capital gains tax rate, and I have long been supportive of these efforts, so I am pleased that a capital gains tax cut has been included in the Job Creation and Wage Enhancement Act. Also included in this legislation are changes to increase the current estate and gift tax exemption from $600,000 to $750,000, which I also strongly support. I am pleased that the Act would index these levels for inflation, so the Congress will not have to continually amend these levels. Another component that I strongly support is the clarification regarding the home office deduction for those taxpayers who conduct significant administrative business task at their home.

The Contract with America embodies the sentiment of the new Congress that Washington is no longer the only solution to our nation's problems. The most well-intentioned, broad-brush, national solutions from Washington, D.C., cannot hope to address the specific, unique problems of St. Petersburg, Florida. Instead, by passing this Contract, Congress can help individuals and states help themselves, and free them from the restraints imposed by past attempts by Congress to run their lives for them.

The Personal Responsibility Act exemplifies this change in priorities. By giving states the flexibility and funding to design welfare systems that meet the needs of their residents, instead of their resident federal bureaucrats, Congress will offer hope to hundreds of thousands of Americans currently receiving funds from AFDC, SSI and other federal programs. I endorse the bill's provisions to reduce illegitimacy, stimulate employment, and restrict the alarming growth of welfare spending, a funding explosion that has failed to achieve its goal. I have supported legislation in the past to provide comprehensive welfare reform, and I look forward to working with my colleague from Florida, Chairman Clay Shaw, in his historic redefinition of government's role in American society.

It encourages me to see the trust we grant states to reform their welfare systems will extend to other issues as well. For too long, Congress has micromanaged state behavior with onerous environmental, transportation, labor, and other regulations that demand compliance, yet refuse them the funding to enable it. State and local governments have been forced to divert their own scarce, public funds into the enforcement of federal policies. I wholeheartedly endorse efforts to eliminate these unfunded mandates, by federally funding legitimate regulations or terminating unnecessary burdens.

Often, the states most affected by these mandates operate with a level of fiscal discipline the Congress has been unwilling to match. In this Congress, however, we have an opportunity to emulate them by enacting a Balanced Budget Amendment to the Constitution. As a consistent cosponsor of similar legislation in past Congresses, I have watched our nation become so numb to our fiscal plight that we treat a reduction in the size of the annual increase in the deficit as a success. This is like lifting our foot just a little off the gas pedal of a car heading over a cliff. We need to hit the brakes. By requiring a balanced budget and giving the President a line-item veto, the Fiscal Responsibility Act will force future Congresses to control government spending, and protect the economic rights of generations to come.

Finally, the Committee will take up key portions of the American Dream Restoration Act. I have long been a critic of the so-called "marriage penalty", and believe that the government should not punish people for getting married. The family is the core of our society, and the Congress should be approving legislation that supports our nation's families, not penalizing them. I support the reform of the marriage penalty, where married couples pay more in taxes than they would as two singles. Also contained in this legislation is a $500 per child tax credit for families with annual incomes up to $200,000. Last, but certainly equally important, the American Dream Restoration Act creates the American Dream Savings Account (ADSA). I know the members of this Committee are as concerned as I am about our nation's low savings rate when compared to the rest of the world. By allowing individuals to contribute up to $2,000 a year into an ADSA, our nation can increase its savings rate and enable more workers to plan for their retirement years. Individuals can make tax-free withdrawals if used for retirement income, for a first time home purchase, for post secondary education expense, or for medical emergencies or purchasing long-term care health insurance. While the initial deposit is taxed, by allowing these accounts to accrue tax free for these purposes, we will foster the American dreams of home ownership, a better job, and retirement security.

Mr. Chairman, I thank you for the opportunity to testify in support of all these programs, and I look forward to working with you to bring these changes to the American people.

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